SWITZERLAND - CARVING A NICHE IN EUROPEAN M&A

in association with:

PRAGER DREIFUSS
RECHTSANWÄLTE
ATTORNEYS AT LAW

Daniel Hayek
Partner
Prager Dreifuss
+41 (0) 44 254 55 55
daniel.hayek@prager-dreifuss.com

Blum&Grob
ATTORNEYS AT LAW

Ralf Rosenow
Partner
Blum&Grob Attorneys at Law
+41 (0) 58 320 00 00
r.rosenow@blumgrob.ch

MARCHMONT

Roland E. Staehli
Managing Director
Marchmont AG
+41 (0) 44 215 90 30
roland.staehli@marchmont.ch

KELLERHALS HESS.

Dr. Beat Brechbühl
Attorney
Kellerhals Hess Rechtsanwälte
+41 (0) 58 200 35 30
beat.brechbuehl@kellerhalshess.ch

TCFG The Corporate Finance Group
Mergers & Acquisitions

Beat Unternährer
The Corporate Finance Group
+41 (0) 44 287 22 50
Beat.Unternaehrer@tcfg.ch

LENZ & STAEHELIN

Andreas Rötheli
Partner
Lenz & Staehelin
+41 (0) 58 450 70 00
andreas.roetheli@lenzstaehelin.com

Edgar Brandt
Advisory SA

Edgar Brandt
Edgar Brandt Advisory
+41 (0) 22 799 42 81
edgar.brandt@eb-advisory.com

S • E • C • A
Swiss Private Equity & Corporate Finance Association

Dr. Massimo S Lattmann
Chairman of SECA,
Venture Partners AG &
Redalpine Venture Partners AG
+41 (0) 44 206 50 80
mslattmann@venturepartners.ch

WEIGEL CORPORATE FINANCE

Dr. Winfried Weigel
Weigel Corporate Finance
+41 (0) 41 760 87 30
office@wweigel.com

CAPVIS

Tobias Ursprung
Equity partner
Capvis Equity Partners AG
+41 (0) 43 300 58 28
Tobias.Ursprung@capvis.com

SWITZERLAND HAS LONG BEEN KNOW AS A MAJOR GLOBAL PRIVATE BANKING SECTOR DERIVING MUCH OF ITS WEALTH AS A COUNTRY FROM THE PROVISION OF FIRST CLASS BANKING SERVICES TO SOME OF THE WORLD'S WEALTHIEST PEOPLE.

While the financial districts of Zürich and Geneva continue to thrive, this is not the only industry that defines the Swiss economy. The country has a thriving biotech sector closely linked to its excellent university system and is well know for pharmaceutical excellence and luxury goods. There are also vibrant Swiss manufacturing and services sectors.

SWISSM&A


Winfried Weigel


Andreas Rötheli


Beat Brechbühl


Beat Unternährer


Daniel Hayek


Edgar Brandt


Massimo Lattmann


Ralf Rosenow


Roland Staehli


Tobias Ursprung

Venture capital and private equity money from within and outside Switzerland is attracted to these sectors on a regular basis, helping to fuel trade buy outs and IPO activity.

Figures from the Swiss Private Equity and Corporate Finance Association (SECA) show that funds raised in 2007 dropped slightly on 2006 figures, from €1.6 billion to €1.5 billion, with the majority of that money provided by independent investors. The amount of that money allocated to buyouts halved to €723.1 million, while venture capital allocations tripled to €690.7 million from €231.5 million. These figures reflect the shift from bigger debt-laden buyout deals to smaller transactions with higher proportions of equity, in line with the retrenching of capital markets in the credit crunch.

Around €905 million of private equity money was invested in Switzerland during 2007, with €171.1 million going into early stage investments in industries such as biotechnology. Around €274 million went into expansion capital and €435 million into buyouts.

Just six firms in the consumer goods sector received €358 million of investment, reflecting the mature nature of the sector. Most deal activity took place in the life sciences and computer and consumer electronics sector, as 84 deals were done with 46 companies, totalling €258 million or 20% of the total deal volume.

It is these vibrant fragmented sectors, including biotechnology, that are lighting up the Swiss M&A scene at present and attracting the dealmakers.

Switzerland's Biotech Success Story

The success of the biotech industry in Switzerland is linked to the history of so called 'big pharma' in the country.

The pharmacy sector's pre-eminence has led to an excellent university-led research base in the biotech sector, ultimately leading to plenty of spin-off companies, looking to commercialise new inventions or developments born out of academia.

Ralf Rosenow, head of life sciences and capital markets at Blum&Grob Attorneys at Law, based in Zürich, says the presence of big Pharma players like Roche and Novartis has created a huge talent pool in all areas of biotech.

He said: "Switzerland's universities provide an enormous technology and innovation output, which offers a continuous flow of opportunities for technology spin-outs and other forms of start-ups."

This talent pool has led to a cluster culture of complementary biotech start-ups feeding off each other.

Massimo Lattmann, chairman of Venture Partners AG and of Redalpine Capital, who is also chairman of SECA, identifies clusters around Zürich and Basel that have sprung up during the last 15 years. These clusters are dominated by life sciences, which is attracting capital from business angels and institutions.

Beat Unternährer, partner at The Corporate Finance Group, which has offices in Zürich, Geneva and Berne, believes a culture of cross fertilization between big pharma, the biotech start up industry and universities is the main reason for this.

He said: "At the Federal Institute of Technology (ETH) in Zürich, slightly more than 20% of all spin-offs are in biotech, third only to IT and consulting services. Almost half of them are VC-backed, a ratio that's unmet by any of the other sectors."

He added: "There are, on the one hand, institutional investment firms such as HBM Bioventures and on the other hand corporate venture capital such as the Novartis Venture Fund. We also see impressive activity among private investors. Firms such as Speedel have financed a major part of their growth with private money."

NOBODY KNOWS WHAT WILL HAPPEN, THERE ARE MANY DIFFERENT SCENARIOS THAT COULD TAKE PLACE

Tobias Ursprung

This level of dynamism is unusual in most other Swiss industries and is an attractive feature of the sector.

Roland Staehli, CEO of Zürich-based corporate advisory firm Marchmont, says the Swiss Government recognises this dynamism and works to encourage it.

He said: "The Government agencies realise this is a very important sector and do everything they can with the regulations to benefit it. There is excellent cooperation with the universities and this brings dynamism. Very often ventures are initiated by lecturers and academics from the universities who find something and spin it off as a company."

He added: "Early stage funding is available because the sector has an excellent reputation. It has proven many times that it does good research and has good products, so they find it easier to find good capital."

The role of the universities in the rise of biotech is also emphasised by Andreas Rötheli, partner at the Geneva office of law firm Lenz Staehelin.

He says that the outstanding scientific reputation of academic institutions in Switzerland helps to enhance the cooperation between universities and industry. He highlights the fact that there are more than 130 biotech companies and more than 80 biotech suppliers in Switzerland; the world's highest per capita biotech density.

He said: "Swiss academic institutions enjoy an outstanding scientific reputation throughout the world with regard to basic and applied research. This reputation is largely the result of substantial cooperation between universities and industry. Swiss and foreign private equity plays a major role; there are many venture capital and private equity funds as well as various science parks and incubators which help promoting Switzerland as a prime business location for life science companies."

This view is supported by Daniel Hayek, partner at Prager Dreifuss law firm in Zürich.

He said: "The polytechnic institutes in Zürich (ETH) and Lausanne (EPFL) are not only rated as amongst the top universities worldwide, but are also at the forefront of science concerning practical input. Lausanne has a renowned program for transferring scientific knowledge into ventures. Moreover, the Federal government has decided to grant several billion Swiss francs to scientific projects, of which a large part will be dedicated to biotechnology."

The Economic Crisis and the Deal Market

No country, particularly in Europe, is immune from the global economic downturn and the same is true of Switzerland. Deal volume slowed considerably towards the second half of 2008 and investors are being far choosier about how they invest their money. As a result, there seems to be plenty of advisers trying to put deals together, but very few of them actually getting completed, mainly due to a lack of finance.

Tobias Ursprung is an equity partner at mid-market private equity fund Capvis. The firm has raised and fully invested two funds since 1998, the first of which has fully exited. It recently raised a third fund (Capvis III) of €600 million and has made two investments so far.

Capvis invests about €20 -100 million in each equity operation, in firms with a turnover between €50-500 million. Its latest investments are in KVT the Swiss fastenings and sealing technology products group and Bartec, the German industrial safety technology firm.

Mr Ursprung says that the current downturn means they will focus their attention to looking after existing portfolio companies in Capvis II and III.

He said: "We are focused on our portfolio companies at the moment; so exits aren't as important at the moment, it is more important to prepare our companies for different scenarios in a downturn. Pricing transactions is extremely difficult at the moment, hence there are few closed deals."

Mr Ursprung points out that debt for deals is still there to be had, although pricing is higher and equity houses have to work harder to sell the deal.

He said: "As a leveraged buyout house, we are with banks. It is becoming more difficult, but is still possible. We have just done a substantial refinancing of a shareholder loan and two substantial acquisitions in July with syndication to other banks. The debt amounts are lower and the interest rates higher, so the percentage of equity you have to inject is higher, although the Swiss banking environment is still a bit easier than abroad. With a good reputation you can still get some financing. We have started to look at methods to lower the external financing needed, for example putting in more equity or using vendor loans."

Many Swiss corporate finance advisers are finding that they have lots of deals in the diary, but many are not completing because of the lack of finance. This has even led to some asking for a retainer before agreeing to start working on a possible deal.

Winfried Weigel, a corporate finance adviser based in Baar, says he is working on lots of deals at present, including France, the US and South America, but is concerned that the funding isn't around to complete them.

He said: "We have the busiest year ever, in terms of active mandates, but in terms of closed transactions activity is substantially lower than the year before. Most of the transactions are pending due to necessary financing. We are working on a public deal in France at the moment and an overseas one in South America. There are tonnes of international deals, but all have a substantial amount of debt or acquisition financing involved and that is extremely hard to get at the moment."

He added: "Private equity firms can afford to do smaller deals with pure equity, so they can afford to do it without external financing and can seek it at a later stage. The bigger deals are just not being seen. Overall, there has just been one deal announced for a Swiss target of above CHF 1 billion in 2008, that has not yet closed. Many M&A advisers are very cautious not to take on mandates without retainers. Buyers are still on the sidelines looking for even cheaper deals, including private equity houses. Due to lack of acquisition finance, sellers don't want to sell on multiple levels reached at the capital markets."

Emphasis on Due Diligence

Due diligence is an important area of deal making that has been affected by the closer scrutiny of lenders and investors. Research into investment targets has taken on a greater importance as a way of soothing the nerves of anxious investors.

Edgar Brandt, of Edgar Brandt Advisory, based in Geneva, believes due diligence is a hot topic for most private equity investors.

He said: "The importance of due diligence in the investment process cannot be overstated, and it is a hot topic for private equity investors. As the industry has grown and matured over the years, it

has had to go beyond the typical investments situations and recipes that made its early successes; achieving superior returns has become more challenging."

He added: "Structural developments have combined with the business cycle to create a strong need for due diligence processes that go beyond the statement of facts and bring strong contents in terms of "connecting the dots". They must also be backed by strong personal commitments from those in charge of the process."

Roland Staehli, from Marchmont, also emphasises how nervousness in the markets can translate to investors demanding extra work from due diligence providers, even if it is excessive.

He said: "We do get more questions from nervous buyers than we did before, and we spend more time on due diligence, but not to a significant degree. We always tell buyers that we do thorough due diligence in every deal, but when there are clouds in the sky buyers get more nervous and ask for more information."

Recent Deals Done in Switzerland

A variety of deals have been closed out in Switzerland during the last year in sectors such as telecoms, biotech and retail.

Mr Rosenow at Blum&Grob has closed three private equity and venture capital financings in the biotech and IT sectors. He has also worked on a handful of M&A transactions focusing on electronic media. The public takeover of Speedel by Novartis with a value of almost CHF 1 billion, was the most high profile deal he worked on.

Beat Brechbühl, partner at law firm Kellerhals Hess in Bern and Zurich, is working on several ongoing transactions regarding a consumer goods company in Germany, plus a pharma and a medtech business in Switzerland and a private equity transaction in the energy sector. More recently he has advised BV Group in the acquisition of Lonstroff from 3i, private investors in the sale of BNS Group to TELAG, the sale of Senevita to Sencura and the spin-offs of restaurants and winery retailers of the Hess Group.

Edgar Brandt Advisory's most recent deal involved a US-based electronic wholesale company and a Middle Eastern infrastructure venture in the $200-800 million size bracket. The firm has also done deals in the luxury industry, consumer goods and air transport sectors.

Roland Staehli, at Marchmont, has recently advised two Swiss luxury goods companies and a European financial services group. Marchmont specialises in these sectors.

Beat Unternährer, partner at The Corporate Finance Group, has been active in some high profile Swiss deals, including the sale of Lonstroff to BV Group on behalf of 3i and the sale of Diamed to Californian firm Biorad Laboratories. They also acted on the LBO of Pinova by Munich-based buy out firm Afinum.

Massimo Lattmann, at Venture Partners AG, specialises in venture capital, but did work on the merger of SIX-listed Amazys with Nasdaq-listed X-Rite.

Andreas Rötheli at Lenz & Staehelin has worked on the acquisition of BNS Group and its subsidiary TELAGcompany AG by PREMIUMcommunications. He also advises two buy-out funds in large proprietary transactions.

Lenz & Staehelin also advised the Swedish telecom group Tele2 AB in its sale of Tele2 Switzerland to TDC Sunrise for SEK 300 million (CHF 45 million) in cash.

The firm also represented the Mansford group, a European multi-strategy real estate private investment group, in the sale of three buildings to Swisscanto Anlagestiftung for CHF 87 million.

Daniel Hayek from Prager Dreifuss represented the bank in the acquisition of BNS Group which provided acquisition credit facility to the buyer required to finance the purchase price.

Daniel Hayek, from Prager Dreifuss, recently represented a French company listed at the Paris stock exchange (CAC 40) as lead counsel in the acquisition of a Swiss technology group sold by a Swiss listed company. The purchase price was approximately €360 million, the deal closed in October 2008.

Daniel Hayek has also worked on an acquisition the acquisition of a Swiss pharmaceutical group for a purchase price of €30 million with an acquisition credit facility from a German bank.

Weigel Corporate Finance advised on various deals in the telecoms sector and the energy sector. The biggest transactions, however, took place in neighbouring countries, helping a German food company do an acquisition in Austria and a Swiss buyer do a deal in Germany.

Legal environment in Switzerland

The corporate law environment in Switzerland is advanced and well able to accommodate a wide range of complex company structures.

There is still a major revision of Swiss corporate law being undertaken and the finished product is some way off, however the changes are already making themselves felt.

Switzerland's approach to M&A is generally liberal and most advisers are satisfied, despite the odd complaint.

Beat Brechbühl, at Kellerhals Hess, says this liberal approach is highlighted in many areas, including low seller's side tax rates and low capital gains for individuals.

He said: "After enactment of the law on mergers there are somewhat more legalistic but transparent rules which enhance efficiency. Employment laws are much less protective than in other countries (you may lay off at will) and organisation-wise, one may profit from the high flexibility of a non-written group law."

Ralf Rosenow, from Blum&Grob, says the most important changes proposed include flexibility in the capital structure of Swiss companies.

He said: "For me, the most important change proposed relates to an increase in flexibility in the capital structure of Swiss companies, such as the proposed introduction of a "capital band" in which the capital may oscillate depending on the needs and the current situation of the company. We will see how much of this will actually be included in the new law, and what other provisions will be introduced in the aftermath of this financial crises. We can only hope that this will not again result in an even more increased level of regulation making the life of Swiss start-ups and small companies even more burdensome."

The complexity of the Swiss tax system is the main cause of concern for Andreas Rötheli of Lenz Staehelin, although he is generally positive about the general corporate law environment.

He said: "There are no real difficulties with the legal system that hinder my work; the exception is the, sometimes, difficult tax. The system has three different layers of taxes (communal, cantonal and federal); the issue of indirect partial liquidation is also still not resolved. These small disadvantages are largely counter-balanced by the low tax rates and the well established practice to obtain legally binding tax rulings from the competent tax authorities, in most cases on a rather short notice."

Mr Rötheli added: "Corporate law is in the (very slow) legislative process of being amended on various issues such as shareholder rights and capitalisation, corporate governance, shareholders' meetings, bookkeeping and financial accounting."

Debt pushdown and upstream assistance

The concept of debt pushdown is employed when an acquisition vehicle takes on a lot of debt in order to complete a purchase. Since it is just a shell and has no way to service that debt in itself, it attempts to push that debt, or responsibility for that debt, down into a subsidiary company. The subsidiary could then theoretically offset the interest payments against earnings, issue upstream guarantees for the debt, or use its assets to secure the debt.

Andreas Rötheli, from Lenz Stahelin, says these legal complexities, attempted in leveraged transactions, are frowned upon by Swiss corporate law.

He said: "Swiss corporate law is based on the concept that each company pursues its interest on a stand-alone basis. Accordingly, a company would not guarantee a third party debt or pledge its assets in favour of a third party unless it was adequately compensated. It is obvious that in reality these concepts do not apply where a company is part of a group of companies."

He added that any benefits provided without compensation (ie not at arm's length) are considered constructive dividends and would attract a withholding tax of 35% and income tax at subsidiary level.

Offsetting interest payments on debt in a parent company with earnings in a subsidiary, within the frame of an acquisition finance structure, may be seen as tax evasion by most cantons in Switzerland, according to Daniel Hayek, from Prager Dreifuss. He believes this interpretation of the law is particularly restrictive in the cantons of Zürich and Berne.

He said: "Although it is legally possible to merge the acquisition vehicle with its subsidiary, the tax authorities of many of the Swiss Cantons do not accept this tax structure and regard it as an evasion of taxes. The result is that interest costs, under acquisition finance loans, can generally not be made tax effective until the credit is fully repaid.

Beat Brechbühl, agrees that Swiss corporate law does not provide for a specific group statute in which tax efficient upstream loans and debt pushdowns can be done at will.

He said: "A tight frame has to be observed when providing financial assistance to affiliates (at arm's length principle). Non-compliance may lead to the invalidity of an upstream loan, as well as to directors personal liability, have adverse tax implications, be qualified as an criminal offence or as a fraudulent conveyance under the bankruptcy law. However, it is still common and required for leveraged financed transactions."

Exits, IPOs and the SiX

Initial public offering or IPO is a fairly common form of exit for private equity firms, particularly in the biotech and cleantech sectors, due to the strength of the Swiss Stock Exchange (SIX) in these industries. It is not, however, the most common form of exit, particularly since the start of the economic downturn.

Edgar Brandt, of Edgar Brandt Advisory, says that an IPO is the best way of gaining a broad recognition of a new product; explaining its popularity with biotechs.

He said: "A public listing is seen as providing much better access to future growth.

A significant part of the Swiss PE/VC sector is active in that sector, and, as far as we are aware, the majority of foreign PE/VC firms setting up operations in the country do so with the intention of investing in biotech."

Beat Unternährer, at The Corporate Finance Group, believes trade sales are generally far more important, estimating that just 20% of private equity exits are via IPO. This view is support by Beat Brechbühl of Kellerhals Hess.

Mr Unternährer said: "A study undertaken by the Federal Institute of Technology (ETH) shows that out of 130 university spin-offs from 1998-2007 only eight (6.2%) had a trade sale exit and one (0.8%) an IPO exit. Two thirds of these exits were by VC-backed spin-offs, including the one IPO case."

Ralf Rosenow, from Blum&Grob, believes public offerings are currently no longer available for biotechs because of the economic crisis, but says biotech IPOs did see a resurgence between the burst of the dotcom bubble in 2001 and the credit crunch of 2007.

He said: "Looking back 10 years, we see that IPOs have played an important role as an exit route, but only in times when the so called IPO window is open. After the collapse of the dotcom bubble in 2000/1, there was no biotech IPO possible for more than three years. Thereafter we have seen several with Arpida, Basilea, Speedel and others including foreign companies listing on the SIX. Since 2007, when the biotech stocks were hit over proportionally by what is now known as the "financial market crisis", public offerings are simply not available for biotechs. In these periods of closed financial markets, there is an obvious increase in M&A activities by trade and strategic players."

Outlook for 2009

The outlook for 2009 is mixed for the corporate finance arena in Switzerland. Although deal volumes fell a great deal in the second half of 2008, there could be plenty of opportunities for careful investors in 2009, particularly the second half of the year.

Corporate adviser Winfried Weigel believes that cleantech is a big growth area, particularly in cross border deals.

He said: "Cleantech is a big growth area, valuations have come down a lot, the outlook is still bright, so we will see an increased level of M&A deals in the coming year. During the past six weeks the valuations of renewables companies has more than halved. They are now affordable for the big utilities, so that will increase M&A activity; we may even see the launch of a big takeover before Christmas."

Winfried Weigel suggests that much of this investment will come from outside Switzerland, particularly from the Middle and Far East. He believes the current market prices will mean that strategic buyers should carefully review asset valuations and possible takeover premia, as well as the shareholder structure of possible targets.

He said: "The current valuation level is artificially low; it is not justified based on the assets being held by these companies and by the long-term earnings perspective. We consider that it's a good buying opportunity, but we think institutional shareholders will be reluctant to sell at this level. There are still financial institutions that have pressure to unwind their overleveraged balance sheets and they might sell at these prices, but value investors will not, unless they can expect a huge premium.."

Tobias Ursprung, of Capvis, says his outlook for 2009 is speculative, meaning he will be preparing for a range of, very different, scenarios.

He said: "Nobody knows what will happen, there are many different scenarios that may take place, we have to prepare our companies in such a way that we can move either way. There must be the measures in place to act decisively if things get tough, but if it doesn't turn out as bad as everyone believes, then we have to be prepared for growth."

He added: "In the first half of the year we will take care of our existing portfolio companies and think about add-ons for them, in the second half of the year the picture might look different again."