

market intelligence

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GETTING THE
DEAL THROUGH

M & A

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panel covering 20 key economies

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confidence
returning?

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market intelligence

Welcome to *GTDT: Market Intelligence*.

This second issue focuses on the global M&A markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

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Rudolf Rentsch

M&A IN THE CZECH REPUBLIC

Rudolf Rentsch is the founding partner of Rentsch Legal, an independent boutique law firm in Prague with an international scope. He specialises in cross-border and domestic M&A transactions, venture capital and private equity, and corporate and commercial law. He has provided advice to multinationals as well as direct private investors in connection with their investments or divestments, in the Czech Republic and other countries in the region.

Recent projects include advising the now former owners of Impact-Corti, a leading Czech property manager, in connection with the sale of their business to CBRE, the support of the sponsor in a management buyout of

a leading Czech IT company, and the support of the owner of a leading marketing/IT company in connection with the sale of his business to a foreign investor.

Rudolf co-owns Sauter Rentsch Investment Services, a Prague-based corporate finance/M&A boutique. Prior to establishing Rentsch Legal, he was a local partner of the Prague office of Gleiss Lutz/Schönherr. Before moving to Prague, Rudolf worked with leading Swiss firm Homburger. Rudolf is admitted to the Czech and Swiss bars. He graduated from the Swiss universities in Lausanne (lic iur) and Basel (Dr iur) as well as from the University of Chicago (LLM).



“M&A activity has reached the pre-crisis level in terms of the number of transactions, but not yet in terms of their average size.”

Photo: Rudy Balasko / iStock / Thinkstock

GTDT: *What trends are you seeing in overall activity levels for mergers and acquisitions in your country during the last year or so?*

Rudolf Rentsch: In the Czech Republic, as in all neighbouring developed economies, the overall activity level for mergers and acquisitions has increased over the past year. According to most studies, the number of transactions increased 30–70 per cent in 2013 compared with 2012. Thus, 2013 was the busiest year in terms of M&A in seven years. This general trend seems to be continuing in 2014.

The activity level has therefore reached the pre-crisis level in terms of the number of transactions, but not yet in terms of their average size. There have been a number of large-scale transactions lately, such as the acquisition of the Czech subsidiary of Telefónica O2 by PPF Group or the purchase of Net4Gas by a consortium of Allianz Capital Partners and Borealis Infrastructure Management from RWE.

Five recent trends are particularly interesting. Western European energy and utility companies are selling off their Czech assets. RWE disinvested and German E.ON exited from Prague’s gas company Pražská plynárenská. Among the drivers of this trend are the aim to improve the balance sheet and a focus on other regions, such as Asia and South America.

Business owners are increasingly dealing with succession issues. Founders who established their businesses in the early years after the Velvet

Revolution are now approaching retirement age and are searching for new owners.

A growing number of large-scale deals feature Czech buyers. In 2013, half of the buyers of the top 10 deals were Czech entities.

The Czech Republic has become a strong regional investor, given that it has competed in more outbound transactions than any other country in central and southern Europe. This signals that the Czech economy and its players are highly developed. This trend will persist as well, not least due to the fact that the number of suitable targets in the domestic market, given its limited size, is finite.

Chinese investors are increasingly seeking investment opportunities in the CEE in general and thus also in the Czech Republic. Several initiatives both on government and industry levels have recently been launched to strengthen mutual ties. This will automatically also lead to increased M&A activity involving Chinese investors.

GTDT: *Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?*

RR: Lately the busiest sectors in terms both of deal size and volume have been the energy and utilities sector, the real estate sector, followed by retail and consumer goods, and the industry and services sectors.

The increased activity level in the energy and utilities sector is due in particular to the trend of

western European investors shifting their interest away from the Czech Republic to either their home markets or other economies. As regards real estate, foreign investors are returning after having somewhat neglected the Czech market over the past years. This may have been due to more promising yields in markets further east. Following the latest turmoil in Russia and Ukraine, and the unstable economic climate in these countries, investors seem to appreciate the safer environment in the Czech Republic coupled with its interesting return on investment compared to most western European countries.

In the retail sector, we are seeing further ongoing consolidation, while the increased demand for high-quality products is motivating new players to enter the markets, thus putting additional pressure on the incumbents. This is more than welcome, not only from the consumer's perspective, but also from an M&A practitioner's view. Either tendency triggers additional M&A activity.

In terms of size, most deals range between €5 million and €100 million. In exceptional cases, the size exceeds €2 billion. One such deal was PPF Group's acquisition of a 65.9 per cent stake in the Czech subsidiary of Telefónica O2 for a total consideration of €2.5 billion. Most other deals are significantly smaller, thus reflecting the smaller size of the Czech economy compared to Germany, France or the UK, not to mention the US or China.

GTDT: What were the recent keynote deals? What made them so significant?

RR: Apart from the deals mentioned earlier, I would highlight the acquisition by Ahold of Austrian Spar AG's supermarket business in the Czech Republic for €265 million. Ahold thus becomes the second-largest player in the Czech supermarket sector. After Carrefour quit the market several years ago, just like Belgium's Delhaize Group, Spar is the next significant retailer to back out of the Czech Republic. Tesco, Lidl/Kaufland and Metro Group, to name the most important international players, remain active here.

GTDT: In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your country primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

RR: Czech sellers typically prefer cash considerations. This is true across the board, regardless of size. PPF paid cash, RWE sold for cash, and Ahold paid cash. This is in line with our practice as well. We only exceptionally see share transactions. This does not mean, however, that

Czech sellers refuse share considerations as a matter of principle. I would expect that a Czech seller would be as willing to accept shares of the buyer as any other seller in the world, if the shares offered are interesting.

GTDT: How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your country?

RR: The legal framework changed dramatically on 1 January 2014. Czech private law and corporate law underwent a fundamental overhaul. In terms of M&A, this concerns especially the new Act on Business Corporations and the new Civil Code. Among the most important amendments, which are relevant from an M&A perspective, are increased liability of the statutory bodies, new options in terms of creation of various classes of shares in



limited liability companies, and new structural and organisational options in joint-stock companies.

The courts have yet to answer numerous legal questions, and this does not appear likely to change soon. As a result there is a rather high level of legal uncertainty, which is fuelled by attempts on a government level to re-amend numerous provisions. Over time, however, practice will gradually overcome this uncertainty, and in the long run the advantages of the new law will no doubt outweigh its present disadvantages.

This being said, the higher level of legal uncertainty at present should not generally have a negative impact on M&A deals. Rules pertaining to transfer of shares have not changed. The same is true for mergers and demergers under the Transformation Act. Therefore, the new law should not prevent a given transaction from materialising.

In terms of merger control, the principles have been valid for many years. The regulation is, of course, modelled upon EU law. Therefore, there are no surprises in this respect.

Last but not least, the tax regime has also been quite stable lately. Overall, the regime is favourable compared with the tax regimes of surrounding countries. Hence, taxes are not a reason to steer clear of the Czech Republic.

GTDT: *Describe recent developments in the commercial landscape. Are buyers from outside your country common?*

RR: Yes, over the past 25 years buyers from outside the Czech Republic have been very common. Investors from Western countries took advantage of the favourable conditions for transferring manufacturing plants to the Czech Republic. The automotive industry is particularly well represented, with manufacturers such as Volkswagen Group, Hyundai, Toyota and PSA Group maintaining production facilities around

the Czech Republic. Suppliers on all levels have followed in their wake.

Other notable foreign investors across various industries include Nestlé, Kraft/Mondelez, Danone, Bayer, Lonza, KBC, Société Générale, Unicredit Group and Saint-Gobain, to name only a few. Basically, all of the big players had already entered the country in the 1990s.

Over time, however, labour costs naturally increased, and mass production moved further east. Instead of closing their Czech plants, however, most investors established more sophisticated production or R&D centres. We also increasingly see multinationals setting up their regional headquarters in the Czech Republic – mostly in Prague. It does not always have to be Vienna!

In terms of cross-border activities, more and more Czech investors are acquiring businesses abroad, not only in other countries in the CEE but also in western Europe and Asia. Notable Czech investors abroad include PPF Group, Agrofert (which is owned by the current Czech Minister of Finance) and EPH.

GTDT: *Are shareholder activists part of the corporate scene? How have they influenced M&A?*

RR: No, shareholder activists are not really part of the corporate scene. This is a logical consequence of the small number of companies listed on the Prague Stock Exchange and thus the low market liquidity. Unlike regional competitor Warsaw, Prague is not really significant in terms of being a capital market. Consequently, they do not influence M&A. The last important public M&A deal was PPF's investment in O2. This whole process went smoothly.

GTDT: *Take us through the typical stages of a transaction in your jurisdiction.*

RR: As probably anywhere else, there is no typical way in the Czech Republic for an M&A transaction to be managed. The process largely depends on the size, kind and (financial) shape of the business to be sold. In large deals with a transaction value of €40 million or more, the buyer or the seller will typically hire a financial adviser who will be in charge of managing the entire process. As there are not many deals of this size in the Czech Republic and as there are many financial advisers – big and small – we see an increasing involvement by financial advisers in smaller and medium-sized deals.

That being said, it is no exception for a financial adviser to trigger the entrepreneur's willingness to sell his or her business. As I already explained, we are facing the first generation of entrepreneurs post-revolution who have to deal with the succession issue. They do not have any experience

“The higher level of legal uncertainty at present should not generally have a negative impact on M&A deals.”

THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

The most exciting thing in our M&A practice consists in coping with often strongly diverging characters on the sell and buy sides, in particular in private M&A cases. In those instances, the typical seller is a self-made entrepreneur who has built up his business over 20 years and is used to making decisions on his own without having to consult a board. If the business is sound and has reached a critical size, the buyer is often a multinational group, where the decision-making process is somewhat more complex. Our job then is not in the first place to handle purely legal issues, but to bridge the gap due to differing mindsets, backgrounds and languages.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Apart from being an excellent and experienced lawyer, the counsel should fulfil two main connected criteria:

- 1 He should be a proven dealmaker. In our market, unfortunately, many lawyers still don't have much business sense. They only pinpoint problems without aiming to find

solutions. I have seen many promising deals killed by lawyers.

- 2 He should speak the languages of all the parties involved, and not only in a purely linguistic sense. The manager of a multinational, who has been educated at a leading global university and has spent years in sophisticated corporate structures, speaks a different language from the entrepreneur who has built up his business from scratch. A counsel who understands both languages can translate, if need be, and thus facilitate the deal.

What is the most interesting or unusual matter you have recently worked on, and why?

The most interesting matter I have recently worked on was an attempted management buyout of a promising Czech IT business. Unfortunately, the speed of the sponsor, a US-German investor, was too fast for the management. It turned out that the gap was too big even for a dealmaker.

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with this kind of project and are thus open to cooperate with a qualified adviser. Typically the process is as follows:

The adviser analyses and values the target business. Together with the entrepreneur, he or she prepares the business for the sale. If the adviser is adept, he or she manages to convince the entrepreneur that a sell-side due diligence is a good investment, which eventually pays back in the form of a higher price.

The adviser prepares the materials to be distributed to the potential buyers later on (ie, a teaser as well as an information memorandum). More importantly, the adviser identifies suitable potential investors. At this stage, lawyers start to become involved. They prepare the contractual transaction documentation.

The adviser approaches potential investors by providing them with the teaser and inviting them to request detailed information on the investment opportunity. In case of a positive reply, the potential investor receives the information memorandum.

Based on the information memorandum, the potential investors are invited to submit an indicative bid.

The adviser and the entrepreneur evaluate the indicative bids and select those potential investors that they will invite to the next round. At this point, they also have to decide whether to grant exclusivity to one particular bidder.

Once the advancing bidder or bidders are determined, they are invited to conduct due diligence. As anywhere else, virtual data rooms are most common. At the same time, the bidders receive the draft transactional documentation. After having evaluated the results of the due diligence, the bidders submit a binding offer, often in the form of an amended draft sale and purchase agreement.

Finally, the adviser and the entrepreneur evaluate the binding bids and determine the winner, with whom they then negotiate the final terms of the deal. Once signed, they then only need to close.

Realistically, this process takes six to 12 months. Quicker deals are usually only made when, for example, the CEOs know each other and negotiate the deal directly, or when the target is in a critical situation and time is of the essence. In either case, deals are usually realised without the involvement of any financial advisers.

The same is true when sophisticated private equity houses strive for and realise deals. They would usually not participate in tenders but rather identify opportunities and, where they can, directly negotiate with the owner of the target.

In terms of legal requirements, Czech corporate law and contract law do not provide for any insurmountable obstacles. Nevertheless, parties in cross-border deals usually choose some foreign law with regard to the framework agreements (ie, the SPA), while the transfer instruments are to be governed by local law. The same is, of course, true whenever it comes to the requirement to obtain any public authorisations prior to the consummation of a deal, which is the case particularly in regulated markets such as energy, telecoms, infrastructure and banking. As regards merger control, larger deals are typically subject to clearance by the European Commission. Only medium-sized deals, which are not subject to EU merger control, may require prior clearance by the Czech antitrust

agency. The merger control rules both in terms of substance and procedure are fairly similar to European regulations.

GTDT: Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your country?

RR: I do not expect any fundamental changes in legislation in the coming years. As I already explained, we have recently gone through the most substantial changes in private law in more than 20 years, so that we will now 'only' face relatively minor changes where the flaws of the new law will be repaired. It now will be important to follow how case law based on the new law will develop. It will definitely be a number of years before most of the important open issues are resolved. Until then there will be some legal uncertainty, but nothing that we cannot cope with. Overall, I am positive that the fundamental amendment of Czech private law will soon pay off.

GTDT: What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active?

RR: I expect that the market will remain lively. While there may not be many blockbuster deals, I see a significant number of interesting medium-sized private transactions. Real estate will continue to be busy, like the energy and utilities and industry. Increasingly we will see activity in the IT sector, not least thanks to a dynamic start-up scene, and green-tech.

Another phenomenon that we will see is the increased activity of Chinese investors in central Europe. China lately has been focusing on outbound investments, not only with respect to the US, Africa and Australia, but also Europe. The Czech government has recently strengthened its endeavours vis-à-vis the competent Chinese bodies and thus has managed to attract some interest here. It's a safe bet that Huawei's investment in the Czech Republic will not be the last one. Our work will remain thrilling in the future, too!



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