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Corporate M&A

Switzerland

Trends and Developments

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M&A Activity Impacted by COVID-19

Unsurprisingly, the COVID-19 pandemic impacted M&A activity in Switzerland in 2020, leading to the second year-on-year decrease in aggregate transaction value after the 2018 record year. While the number of deals decreased by a relatively modest 10%, the aggregate transaction value at approx. USD63 billion more than halved compared to 2019 (USD127 billion) (Source: KPMG, Clarity on Mergers & Acquisitions 2021).

The impact of COVID-19 was especially severe in the first half of the year, particularly from the end of Q1 and throughout Q2 when, along with the spread of the coronavirus to pandemic levels, the uncertainty hit markets throughout Europe and around the globe. Q3 already showed clear signs of a market rebound and despite the severity of the second wave in November and December, activity further increased as the end of the year drew closer, raising hopes for a return to pre COVID-19 levels in the Swiss M&A market – or potentially more.

The sharp drop in the aggregate transaction value for 2020 is also attributable to the absence of mega deals during 2020. The largest transaction by value was Liberty Global Plc's public takeover of Sunrise Communications AG at roughly USD7.2 billion. By contrast, in 2019 Novartis' spin-off of Alcon alone accounted for CHF28 billion in transaction value (based on Alcon's market capitalisation at close of the first day of trading on the SIX Swiss Exchange and NYSE). Other notable deals in the Swiss M&A context included the acquisition of Avaloq Group AG by NEC Corporation at roughly CHF2.05 billion.

Market Trends

Overall, the Swiss M&A market remains open for business and we continue to see strong interest by private equity funds as well as foreign investors. After some questions around introducing an investment control regime, the Swiss Federal Council decided against doing so, except in specific sectors such as residential real estate, aviation, banking and the financial sector more generally, postal services, telecommunications, energy and defence, where a review process is integrated in the sectoral regulatory framework. There continues to be however a debate on introducing such a regime in cases where the national interest is at stake or the foreign state does not grant a reciprocal treatment.

The special purpose acquisition companies (SPAC) frenzy has so far largely bypassed Europe and there have not been any SPAC listings on any exchange in Switzerland. The Swiss Financial Market Supervisory Authority has recently required the SIX Swiss Exchange to implement provisions governing SPACs before allowing any SPAC to list on the stock exchange. As a result, SPAC listings, the first of which had been expected for the second quarter of 2021, have been put on hold. Despite this delay it is believed that Switzerland is likely to see its first SPAC listing during the course of 2021, market and regulatory conditions allowing. More importantly, however, US SPACs are expected to increasingly focus on Europe, particularly in the tech sector. SPACs abroad seeking out targets in Europe and, possibly, Switzerland have the potential to significantly boost deal activity in Switzerland. It is only a question of time before the first SPAC deals are announced.

Shareholder Activism

Even though relative to other jurisdictions, campaigns and instances of confrontation by activist shareholders are still few and far between in Switzerland, shareholder activism has clearly been on the rise in recent years. Examples include the failed merger between Clariant and Huntsman following opposition by White Tale and other shareholders in 2017, the takeover battle over Sika that lasted from 2014 until 2018 when the involved parties reached a settlement and the aborted takeover by Sunrise of cable operator UPC in 2019. There was a notable absence of shareholder activism on a significant scale during 2020 as corporate executives and investors turned their attention to crisis management.

As economies return to normal, it is expected that activist shareholders will no longer hold back and that Switzerland will revert to the trend of increased shareholder activism. The strengthening of shareholder rights that the Swiss corporate law reform will bring about will play in favour of activist shareholders. The reform will, among many other changes, reduce the thresholds to exercise the rights to call a shareholders' meeting, include agenda items and inspect a company's books and correspondence.

COVID-19 and Restructuring

While the COVID-19 pandemic put a stop to strategic M&A, the Swiss market did not experience substantial structural M&A activity by distressed companies. Indeed, the blow sustained by the Swiss industry was softened by government sponsored loans to Swiss companies which were made available to a large array of firms, from small and medium enterprises to larger firms in industries that were particularly hard hit, such as Swiss or SR Technics, in the aviation sector.

At the same time, the government granted exceptional relief from corporate law obligations

to file for bankruptcy to companies that became balance-sheet insolvent after the crisis started. As the second wave of the pandemic and the mutations of the virus continue to affect society at large and slow down the economy, it becomes increasingly likely that some firms will no longer be able to bear the blow and will need to raise funds, which may in turn lead to increased M&A activity to secure equity from new investments.

Circular No 5 on Restructuring Exemption

At the same time, legal developments on public M&A and the mandatory bid rule are likely to affect the flexibility available to investors. On 2 September 2020, the Takeover Board issued a new Circular No 5: Restructuring exemption/restructuring plan of the target company, which seeks to codify its practice on granting exemptions from the mandatory bid rule in connection with restructuring plans.

The Takeover Board expects to receive going forward a restructuring plan describing:

- the situation of the company, its level of equity, debt, actual or impending risks of having a negative net asset value or insolvency;
- the extent of the needs of support in quantitative terms as well as a description of the urgency of the measure together with a liquidity plan for at least the next six months; and
- what measures were considered as an alternative or carried out without any success.

Issuers and investors expecting to seek an exemption from the mandatory bid rule should therefore expect a closer scrutiny from the Takeover Board and be ready to provide comprehensive disclosure, which may prove challenging for a company in need of restructuring.

Selective opting out

Against this backdrop, the route of a selective opting-out of the mandatory bid rule may prove

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compelling to issuers and investors seeking to recapitalise or takeover a company without presenting a mandatory bid. However, the threshold to achieve this goal is also demanding as it supposes that a majority of the minority approves the selective opting-out and thus agrees to forego a mandatory bid, which is a challenging task. The Takeover Board raised the bar, in the recapitalisation of MCH Group SA, the company which hosts, among others, the Art Basel fair, by considering that a large stakeholder does not count as a minority shareholder in a majority of the minority vote. This decision was upheld on appeal by FINMA and it seems that the bar will remain high.

Corporate Law Reform

The Swiss Parliament passed on 19 June 2020 a Bill amending the Code of Obligations introducing a major company law reform. This bill is expected to be enacted in 2022 or 2023. It is likely to have a multifaceted impact on M&A in Switzerland. The new company law will create a capital fluctuation band allowing the board of directors to increase or reduce capital within a range between 50% and 150% of the issued share capital when it is introduced. This will make it easier for boards to issue shares as acquisition currency. Although proxy advisors have in the past signalled that they would not recommend voting in favour of broad-based authorisation to issue shares without pre-emptive rights for existing shareholders.

At the same time, the new company law also makes delisting an attribution of the general meeting of shareholders that requires a qualified majority of two-third of the voting rights and an absolute majority of the capital represented at the meeting. This makes it more difficult for bidders to waive the threat of a delisting to induce shareholders to tender even if the bidder is unable to reach the thresholds required to complete a cash-out merger (which requires a vote of a

qualified majority of 90% of the voting rights) or simply cancel in a squeeze-out outstanding shares (which requires a shareholding of 98% of the voting rights).

Other Regulatory Developments

On 29 November 2020, the so-called Responsible Business Initiative was rejected at the ballot box. Despite gaining a majority of 50.7% of the votes cast, the popular initiative failed to also gain the majority of cantonal votes required for the initiative to pass. The Responsible Business Initiative sought to introduce mandatory due diligence requirements and a liability regime for Swiss companies for human rights abuses and violations of environmental standard committed abroad, including by subsidiaries.

As a result of the rejection of the popular initiative, the Swiss government's counter-proposal will enter into force which will provide for reporting requirements without any rules on liability. Although the Responsible Business Initiative was ultimately rejected, the narrow outcome of the popular vote shows the continuously increasing focus on ESG. This is also underlined by the introduction of gender quota in boards of directors and executive management on a "comply or explain" basis as from 1 January 2021 (but subject to generous transition periods of five and ten years, respectively) that will apply to most listed companies.

Although ESG is typically not perceived as a key focus in M&A transactions, we expect that the heightened awareness and public scrutiny of large corporates in particular will spill over into the M&A market and that buyers are more likely to put a focus on ESG matters both in their due diligence of potential targets and in the transaction documentation, specifically the warranties.

Outlook

As mentioned, markets began to recover as early as Q3 2020 with deal activity peaking in Q4 despite this being the time when the crisis was at its most severe in many countries. The increased activity continued into the early days of 2021 and there appears to be a general sentiment that 2021 may see M&A deal count and transaction value return to, or even surpass, pre COVID-19 levels. This is in part due to the expectation that 2021 will be marked by a catch-up effect which could be observed in late 2020 already. It is also pointed out that market fundamentals are strong, with interest rates remaining low despite the recent increase in treasury yields and cash abundantly available to potential bidders, particularly in private equity.

As the hope for a nearing end of the pandemic induced restrictions is fuelled by the roll-out of the vaccine, management attention is expected to shift away from crisis management and back to growth. Furthermore, while distressed M&A was not as prevalent in 2020 as many expected at the outset of the pandemic crisis, this may also be a question of time depending on how long the situation takes to normalise. It may well be that that opportunities will open up with some delay in the course of 2021 for buyers to acquire distressed businesses or assets from distressed sellers at terms and valuations that are more favorable than in what was generally perceived as a strong sellers' market prior to the onset of the crisis.

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Advestra is a corporate law firm located in Zurich, Switzerland. The team comprises 20 professionals (ten partners, five fee earners and further staff). The firm advises clients on a broad range of M&A transactions, such as acquisition and divestment transactions (including corporate auctions), public takeovers, mergers, demergers, joint ventures and financing rounds. It further advises on complex restructuring transactions and in situations of financial dis-

stress. Clients include private equity firms, public and private companies, sovereign wealth funds and other investors. The firm is also retained by entrepreneurs, growth companies and venture capitalists. Apart from corporate/M&A, Advestra advises clients on capital market transactions (both equity and debt), financing transactions, matters relating to financial services regulatory as well as tax.

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