SWITZERLAND – AGAIN GREAT EXPECTATIONS?

Christoph Neeracher and **Charles Gschwind**, Bär & Karrer AG

MAJOR RECENT ACTIVITY

Bolstered by its reactivated export engine, the Swiss economy once again performed strongly throughout the year 2013 despite a laggard European economic recovery and saw an above-estimate GDP growth of 1.9 per cent according to the State Secretariat for Economic Affairs. The Swiss Market Index, Switzerland's blue-chip stock market index, reached its highest level since 2007 in March 2013 and rose by an impressive 17 per cent over the year.

Unsurprisingly, Switzerland is once again rated as the most competitive economy in the world in the World Economic Forum's Global Competitiveness Report 2013/14. Switzerland's stable political system, liberal economy, highly educated workforce, sophisticated and efficient legal environment, and traditionally mild tax regime all contribute to an excellent business environment and provide a competitive edge over other economies.

Despite these strong economic fundamentals, the Swiss M&A activity was less feverish in 2013 than in previous years and the first three-quarters of the year saw declines on a year-to-year basis in terms of both deal numbers and transaction value according to KPMG. The chief reason for the value-based decline was, however, the notable absence of mega deals such as the $46 billion merger between Xstrata and Glencore in the beginning of 2012, which was only partially offset by a relatively strong mid-market deal activity.

Sellers have been holding back disposals due to moderate valuations and buyers have equally been sitting on the fence, despite favourable financing conditions brought about by record low interest rates and continued confirmation of an expansionary monetary policy by the Swiss National Bank.

Overall, the domestic M&A market has not yet managed to measure up to the high expectations of the market participants despite a deal-friendly macroeconomic environment – creating a potential backlog of deals for 2014, a year that many observers see as highly promising.

LEGAL AND REGULATORY FRAMEWORK

In March 2013, the Swiss voters approved a popular initiative against fat-cat salaries. This initiative, which applies only to Swiss public companies, calls for extensive new mandatory rules on transparency and compensation of board members and senior management:

- the aggregate compensation of the board of directors and the senior management will be subject to the approval of the general meeting of shareholders (say on pay vote);
- severance payments ("golden parachutes"), advance payments and similar extraordinary payments to directors or senior managers, as well as multiple contracts between directors and senior managers and group companies, will be prohibited;
- the articles of association will have to include rules for directors and senior managers on loans, retirement benefits, incentive and participations plans, and the number of positions outside the group;
- the chairman of the board, the board members, the members of the board's compensation committee, as well as the independent proxy will have to be elected annually by the general meeting of shareholders; and
- companies will no longer be allowed to act as corporate proxies but will need to allow shareholders to cast their votes electronically from a remote location.

In November 2013, the Swiss Federal Council published an ordinance implementing and concretizing the initiative. According to this ordinance – which is more business-friendly than anticipated – the first mandatory say on pay vote will not take place before the annual general meeting 2015. Nevertheless, the effects of the initiative have reached boardrooms, where the discussions focus on anticipating and smoothing the impact of the regulatory changes. As a result of the initiative, some smaller listed companies may consider a delisting in order to avoid the new regulations and the related compliance costs. Similarly, private equity players may step in to enable a taking private of listed companies. The first of a potential series of such deals in Switzerland was the sponsor-led taking private of Acino Holding AG in Q4 2013 by Avista Capital Partners and Nordic Capital.

Two further regulatory developments will likely affect the M&A market.

The first is the proposed amendment to the Cartel Act (CartA). The Swiss Federal Council submitted its proposal concerning this amendment to parliament in February 2012, where it is currently pending. Among others things, it plans to introduce a so-called Significant Impediment to Efficient Competition (SIEC) test in merger-control cases. The European Commission and other authorities already use the test. Against the dominance test currently used in Switzerland, the SIEC would lower the threshold for prohibiting mergers. It has to be noted, however, that the ComCo has interpreted the dominance test in a very broad way in some cases. For this reason, the change to the SIEC test would not be expected to bring too much of a shift in practice.

The second is an amendment to the Collective Investment Schemes Act (CISA), which came into effect on 1 March 2013 (and some provisions on 1 June 2013). It aims at further adapting the Swiss regulation to international standards, especially to the Alternative Investment Funds Managers Directive (AIFMD) and hence to guarantee a discrimination-free access of Swiss financial service providers to European financial markets. The amendment is further expected to contribute to the quality and reputation of the Swiss financial market, and to further improve the protection of investors.

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The AIFMD introduces a common regulation for alternative investment funds (AIF) managers at EU level, which brings far reaching regulatory changes for asset managers of alternative investment funds such as hedge funds and private equity funds. AIF managers which are domiciled or managed in the EU or distribute their shares to professional investors in the EU are or will soon be required to obtain an authorisation and be supervised. The AIFMD applies to all EU managers of collective investment schemes, who are not already subject to the Undertakings for Collective Investment in Transferable Securities Directive. The management of collective investment schemes can no longer be delegated to investment advisers domiciled in non-EU states, which are not subject to an equivalent supervision. It is still not clear which conditions third-country AIF managers will have to meet in order to obtain a permission to manage EU AIF and to distribute AIF shares in EU member states. The amendments to the CISA together with the Swiss Financial Market Supervisory Authority (FINMA)'s signing of cooperation agreements with several EU and EEA states were undertaken to increase the probability of securing the delegation of asset management to Swiss asset managers after 2013, and to align the management, safekeeping and distribution rules with the AIFMD.

The partial revision of the CISA makes it mandatory for Swiss asset managers to hold a licence from FINMA in order to manage foreign collective investment schemes and is expected to generate additional administrative costs and higher running expenses for these AIF.

INDUSTRIES AND TYPES OF CLIENTS WHICH HAVE BEEN PARTICULARLY ACTIVE IN THIS SECTOR

On the backdrop of the economic recovery in the US, rising manufacturing costs in China and a still-strained eurozone, Swiss bidders have increasingly turned to US targets. This trend has been mirrored in inbound M&A activity, which has seen a rise of US bidders for Swiss targets. According to a survey conducted by KMPG, seven out of the top 10 deals in Q3 2013 took place between the two countries. Notable inbound M&A deals involving the two countries included the acquisition of RIWISA AG by Flextronics and the $254 million acquisition of Fläkt Woods Group's Global Infrastructure and Industry Business by Colfax Corporation.

The moderate presence of European bidders in Swiss acquisitions can partly be explained by the fact that European bidders are still struggling with the challenging economic environment in the eurozone and partly by the strong Swiss franc, which continues to make Swiss targets relatively expensive despite the CHF/EUR exchange rate floor put in place by the Swiss National Bank. On the other hand, Swiss bidders have been cautious to go after European targets in the wake of the European crisis. The decline in cross-border deals between Switzerland and Europe, which has traditionally been a major source of Swiss M&A deal flow, has further hindered the Swiss M&A market from reaching its full potential.

Swiss M&A activity has been strongest in the industrial goods and services, retail/consumer and TMT sectors. Notable major deals in the respective sectors have involved both strategic and financial players. In the industrial goods and services sector, notable deals included the add-on acquisition of the Boen Group by private-equity owned Swiss parquet manufacturer Bauwerk or the acquisition of Remex's innerspring business by Spühl AG, a Swiss machinery manufacturing company. Retail and consumer sector deals included the acquisition of a majority stake by Swiss mid-market private equity firm Capvis in the Nico tours group or the purchase of the La Tour group of hospitals by HDLT Holding SA. In the TMT sector, a noteworthy transaction has been the acquisition of a majority stake in Cellular Italia by the French private equity fund L Capital.

Switzerland has once again been an active environment for private equity players, who were involved in an array of transactions; although mainly on the buy-side, such transactions also included PE-backed sales to strategic buyers and sponsor-to-sponsor deals.

The acquisition of Informa by Providence Equity Partners for $180 million in July 2013 was among the most notable buy-side transactions, whereas the CHF 721 million sale of AHT Cooling Systems by Swiss-based Partners Group and Quadriga Capital to pan-European sponsor Bridgepoint is a prominent example of sponsor-to-sponsor transactions.

Meanwhile, competition from corporate players remained fierce throughout the year. The largest transactions were closed by strategic players, such as the $1 billion acquisition of Harry Winston by the Swatch Group or the $598 million acquisition of Sevisair by Swissport.

The year 2013 was also prolific for Switzerland's venture capital sector, which saw a number of large-scale exits, such as the $331 million VC-backed sale of the Swiss contact-force measurement company Endosense to St Jude Medical and the sale by a group of incubator investors of Swiss dermatology company Neocutis to Merz North America.

FUTURE DEVELOPMENTS

The macroeconomic environment is expected to remain favourable for M&A transactions, with estimated GDP growth of 2.4 per cent for 2014 according to the State Secretariat for Economic Affairs. On the backdrop of strong economic fundamentals and a backlog of deals, Switzerland is set for a strong uptick in M&A activity in 2014.

In the wake of strong equity markets, the Swiss IPO window reopened in Q4 2013 with Cembra Money Bank (formerly GE Money Bank) raising 918 million Swiss francs in the third-largest European flotation of the year. The positive development in the public exit market is expected to positively affect the private exit market, with (mainly strategic) buyers taking advantage of their significant cash reserves and very favourable financing terms – factors that are expected to lead to an increased deal activity in 2014 both in the public and private M&A sectors.

Further deals are expected in the consumer, energy and financial services sectors. In particular, regulatory changes will likely foster a further consolidation in the energy and private banking sectors. In particular, larger banks and consumer market companies are likely to sell non-core assets in order to put a stronger focus on their core business areas – a trend that was already visible in 2013 and that will likely continue in 2014. One notable such transaction in the financial services sector was the divestment of Aargauische Kantonalbank's private banking subsidiary AKB Privatbank Zürich AG to Privatbank IHAG Zürich AG in November 2013, while Clariant's recent carve-out of its textiles, paper and emulsions businesses to SK Capital, a transaction closed in September 2013, illustrates the trend in the chemical sector.

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