The Board's View

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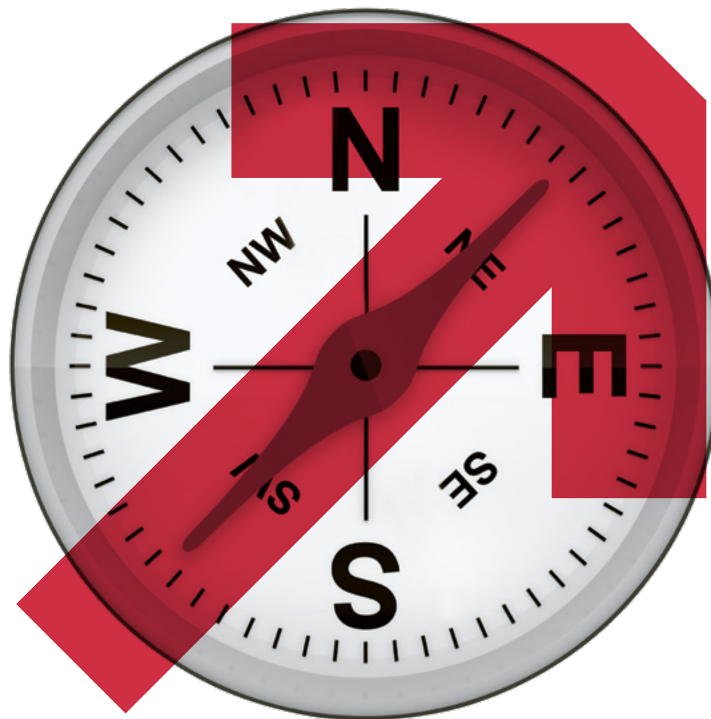

Spotlight: Public-to-private transactions in Switzerland

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Key Take-aways

1.
The downturn in the public equity market could be a catalyst for leveraged buy-outs of public companies (also called public-to-private or "P2P" transactions).

2.
Among other critical considerations, P2P transactions must be carefully structured to accommodate the financing of the cash consideration.

3.
Experience shows that P2P transactions work best for Swiss target companies when the bidder secures the support of an anchor shareholder before launching the offer.

After years of record fundraising, private equity firms have vast amounts of long-term commitments available. Since the outbreak of the Covid-19 pandemic, they have heavily invested private capital in public companies. The downturn in the public equity market could further be a catalyst for buy-outs of public companies (also called public-to-private or "P2P" transactions).

For public companies' management, a battered share price and uncertain recovery may exacerbate the downsides of a public listing. Take-privates could make it easier to conduct carve-outs, and assist management in focusing on long-term value creation.

In this context, the dislocation in the markets caused by the pandemic has placed P2P transactions under the spotlight. This briefing gives an overview of key aspects of this type of transactions in Switzerland.

1 Concentration in the U.S. and the UK

An essential component of a P2P transaction is that its structure and timing accommodate the financing. This feature explains why P2P transactions tend to be concentrated in the U.S. and the UK. In these jurisdictions, buy-outs can generally be structured to "cash out" all shareholders promptly. This makes it easier and cheaper to put in place the financing.

Generally, across mainland Europe, it takes longer and it is more burdensome to squeeze out minority shareholders.

This has a knock-on impact on the financing. However, when carefully structured, P2P transactions can be successful in Europe, including Switzerland.

2 Typical structure in Switzerland

A Swiss P2P transaction will typically take the form of a tender offer. As in other European countries, mergers are not available for a cash transaction (except for a squeeze-out merger as outlined below).

As invariably not all shareholders will tender into the offer, remaining minority shareholders need to be cashed out. This can be done by way of a squeeze-out merger if the bidder holds at least 90% of the voting rights of the target (including via out-of-offer purchases, whether on the open market or privately). Importantly, a squeeze-out merger is a "long form" merger – involving, among other things, a general meeting of the target's shareholders. Minority shareholders have appraisal rights (i.e., they are entitled to apply for the court to "appraise" the value of their shares).

Alternatively, the squeeze-out can take the form of a court process canceling the shares held by the minority shareholders. This option however is only available if the bidder holds 98% or more of the voting power in the target as a result of the tender offer.

3 Minimum acceptance condition

One of the main difficulties facing a bidder in a Swiss P2P transaction is the minimum acceptance condition.

In most cases, the Swiss Takeover Board objects to the bidder setting the acceptance condition at the 90% level. [1]

The minimum acceptance condition is generally around two thirds and can be pushed up to 75%.

There can be exceptions, however, where a 90% minimum acceptance condition appears reasonably achievable. In practice, that has been the case when the bidder already controlled a very substantial stake in the target before launching the offer (mostly 60% or more).

A two-thirds or 75% minimum acceptance condition means that the offer may become unconditional (as to all conditions that expire at the end of the initial acceptance period, including the minimum acceptance condition) without assurance that the bidder will ever reach the squeeze-out merger threshold. A significant toehold is therefore critical to enhance deal certainty.

4 Acceptance levels in practice

Often, the 90% threshold is not attained at the expiration of the initial acceptance period. Among other factors, market makers and index funds typically cannot accept offers until they are declared or have become unconditional. Hedge funds and other activists may also seek to build a blocking position.

In past Swiss P2P transactions where they held a large initial stake or had the support of an anchor shareholder, bidders nonetheless were able to reach the 90% or even the 98% threshold in the additional acceptance period. This is down to a number of factors in addition to the substantial toehold and passive investors' tenders in the additional acceptance period.

First, once the minimum acceptance condition is satisfied at the expiration of the initial acceptance period, non-as-

senting shareholders face the risk of being stuck in a very illiquid stock if they do not tender in the additional acceptance period as a result of a much-reduced free float.

Second, unlike in Germany, the bidder in a Swiss takeover is not required to enter into a domination agreement, compensate any annual loss of the target and guarantee a minimum dividend to minority shareholders to exercise effective control over the target.

Third, non-assenting shareholders can be worse off from a tax point of view if the 90% threshold is reached and they are squeezed out in a merger. That is true for certain Swiss retail investors and, from the perspective of Swiss federal withholding tax, all minority shareholders (although to varying degrees).

5 The squeeze-out

Where it holds at least 90% of the voting power in the target, the bidder can approve a squeeze-out merger on its own.

Critically, it must be avoided that any potential appraisal of the merger consideration taints the price paid in the tender offer.

In Switzerland, the "best price rule" (requiring the bidder to extend to all shareholders tendering into the offer any higher price at which it buys target shares outside the offer) continues to apply for a period of six months after the expiration of the additional acceptance period.

While it is questionable whether the best price rule should be triggered by the appraisal process, in practice the net result is that the bidder should enter into the merger agreement (and effect the subsequent steps, including the holding of the general meetings approving the merger) after the expiration of the six-month period, which will prolong the period during which minority shareholders remain at the level of the target. That period to completion of the process will be a number of months longer than in the UK. [2]

If the 98% threshold is attained, the court process necessary for the squeeze out does not raise any best price rule issue. Non-assenting shareholders will receive the same consideration as that offered in the tender offer.

6 Impact on financing

The potentially relatively long interim period between the settlement of the offer and the effective date of the squeeze-out raises three principal considerations for private equity firms and their financing sources.

First, under Swiss corporate law, the board of directors of the target is duty bound to treat all shareholders equally. That principle will generally preclude the target and its subsidiaries from guaranteeing and pledging their assets as collateral to support the acquisition financing. Upstream guarantee and security could be deemed to benefit the bidder over minority shareholders.

Second, the ability to upstream cash may similarly be more difficult from an equal treatment perspective or result in leakage to minority interests. This raises the question of the ability of the bidder to service the acquisition financing during the interim period (which must be considered when the capital structure is put in place).

Third, while a "debt pushdown" would typically not be recognized from a tax point of view in Switzerland, there are indirect ways of achieving a partial tax shield or deductibility of interest. However, this generally cannot be done during the interim period. [3]

Once the minority shareholders are cashed out, the guarantee and security package can be put in place at the target's level within the usual Swiss parameters governing upstream guarantees and security (which will restrict the scope of the guarantee and security package), as well as tax considerations relating to the "Swiss non-bank rules" to avoid Swiss withholding tax.

7 Practical considerations

Experience shows that P2P transactions - always a complex exercise - work best for Swiss target companies when the bidder secures the support of a major shareholder before launching the offer. Often, public companies across Europe have a large concentration of shareholders, for example family shareholders, that may facilitate a transaction (if such shareholders are willing to sell or roll over their equity). [4] Significant shareholders have in the past themselves initiated the transaction to eliminate the costs associated with public reporting and pursue long-term value creation.

Support for the deal can take the form of an acquisition of a significant toehold, irrevocable commitments (which are required to be "soft" in Switzerland) or a rollover of equity. A buy-out could potentially also follow a PIPE transaction.

In each case, any pre- or out-of-offer acquisition must be carefully structured in light of the minimum price rule, as well as to comply with the best price rule. Bidders have in the past run into issues with private purchases. The consequences can be major.

Successful P2P transactions over Swiss target companies were all friendly or recommended transactions.

[1] This is unlike the UK where the minimum acceptance condition generally can be 90%.

[2] An appraisal will not affect the effectiveness of the squeeze-out merger. In difficult situations, minority shareholders could however seek to challenge the merger on other grounds (for example formal defects) and block the effectiveness of the merger. If that were to happen, that would prolong further the period during which minority interests remain in the target.

[3] Essentially, in its tax structuring, the bidder can consider an equity-to-debt swap, "asset push-up", "management fee push-down" or debt push-down for purposes of financing, especially for taking out existing debt.

[4] Family-controlled public companies represent around 35% of the Swiss listed companies by market capitalization.

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