M&A AND GOVERNANCE PRACTICE AREA REVIEW

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DEAL ACTIVITY AND STATISTICS

As a recent study in *M&A Review* (March 2015) reports, 2014 saw approximately 240 deals, an increase of 13 per cent from 2013. This is still way below the pre-recession years, some of which saw over 400 deals. However, 2013 is a rather low benchmark, as it was a very slow year. Likewise, the increase on the Austrian M&A market is substantially lower than the increase both in German-speaking Europe and internationally. A very positive trend, however, was the number of public bids to reach a peak since the introduction of the Austrian Takeover Act in 1999; these also remained high in the first half of 2015. As with public M&A, private M&A activity remained solid in 2015.

The statistics published in *M&A Review* show that one-third of all 2014 deals were domestic, and that in cross-border deals the number of foreign investors acquiring Austrian targets exceeded the number of Austrian investors buying into the foreign markets. As in recent years, the most sought-after targets in 2014 were from the consumer goods and retail sector, the financial sector, and TMT. In the first half of 2015, the deal activity in the real estate sector was particularly noteworthy.

In private equity, deal activity was good and some major deals were concluded, which continues to be the case in 2015. Due to the limited number of large-ticket transactions, the major private equity funds are not as frequently seen in Austria as mid-cap funds but, as the transactions mentioned below show, the market does have certain targets that attract their attention. Local fundraising, on the other hand, plunged to an all-time low of approximately €13 million, after the previous all-time low of approximately €20 million in 2013; in 2012, however, fundraising exceeded €170 million, as the Austrian Private Equity and Venture Capital Organisation AVCO recently reported.

The start-up scene is developing very well: most prominent is Austria-based Speedinvest, raising nearly €60 million in early 2015. Also, the activity of business angels is steadily increasing, enhanced by such institutional programmes as the €22.5 million EAF Austria – aws Business Angel Fund, aimed at co-investments with business angels. This is a joint initiative of the European Investment Fund and the Austrian federal promotional bank Austria Wirtschaftsservice Gesellschaft mbH (aws). Examples of recent exits include Runtastic, partially sold to Germany company Axel Springer; and YOUSURE Tarifvergleich, partially sold to Bermuda-based Mountains Insurance Group.

RUN FOR REAL ESTATE COMPANIES

In early 2015, activity in the real estate sector was remarkable. Previously, international investors have shown interest in listed Austrian real estate companies. In recent years, local players often outbid international investors when it came to real estate; but the opposite has been seen in 2015. While a voluntary public bid by German Deutsche Wohnen for all shares in Conwert failed because the acceptance threshold of 50 per cent (under the Austrian Takeover Act) was not met, the Austrian Haselsteiner family sold its 24.7 per cent participation in the company to Israeli investor Teddy Sagi. Conwert again holds 95 per cent in the also-listed real estate company ECO Business-Immobilien AG, which was part of the offer launched by Deutsche Wohnen. Likewise, CA Immo was in focus throughout 2014: the company sold participation of more than 25 per cent in UBM Realitätenentwicklung AG to Porr AG; the latter then launched a public bid for UBM. After that, Bank Austria, Austria's largest bank and part of Unicredit, sold its 16.35 per cent stake in CA Immo to the Russian O1 Group for €295 million, which then launched a voluntary partial offer to acquire additional 9.85 per cent to hold a total of up to 26 per cent. With the backing of O1, CA Immo went on to launch a voluntary partial bid for 13.5 per cent in Immofinanz, which responded with the announcement of a reverse (voluntary partial) bid for up to 29 per cent in CA Immo, after losing out to O1 in the auction for the 16.8 per cent stake in CA Immo sold by Bank Austria. As a defence measure, Immofinanz lowered the threshold that triggers a mandatory bid obligation from the statutory 30 per cent to 15 per cent, while CA Immo increased the majority to remove supervisory board members to a 75 per cent majority, making it more difficult for Immofinanz to change the supervisory board of CA Immo, had they acquired up to the suggested 29 per cent. In response, Immofinanz dropped its plan for a bid, which at that point was not even launched. Immofinanz's former subsidiary BUWOG also lowered the formal control threshold, but to only 20 per cent – again, as a takeover precaution. BUWOG was also one of the noteworthy IPOs in 2015, and is now listed in Frankfurt, Vienna and Warsaw. The IPO was implemented via a spin-off to the market, in the same way that Siemens placed Osram on the market. The Austrian Takeover Commission confirmed in a ruling that no mandatory offer was triggered in this case. The largest property deal in 2014 was the €315 million sale of the Millennium Tower in Vienna by German company Münchmeyer Petersen Capital, an auction that attracted the interest of several foreign investors. In 2015, Bank Austria announced the sale of its real estate portfolio in Austria and Central Eastern Europe, which amounts to about 80 properties and a total value of €1 billion.

AUCTIONS FOR BANKS CONTINUE

The sale of private companies often takes place by auction. There is no specific legislation for such auction processes. However, when a state-controlled seller is involved, as with sales procedures for nationalised banks, the process should be transparent and non-discriminatory to provide for a proper defence, under EU state aid regulations, against any argument of other (failing) bidders that the seller effectively granted a subsidy by selling to the prevailing bidder. In late 2014, the South East European operations of Hypo Alpe Adria Bank, which had been fully nationalised in 2009, were sold to a consortium formed by the private equity investor ADVENT and the European Bank for Reconstruction and Development (EBRD). This was driven by a 2013 state aid decision of the EU that forced the government-owned bank to either sell its SEE network or wind down operations. Also in 2013, ANADI Group, owned by Indian investors, acquired the Austrian banking operations of Hypo Alpe Adria. In early 2015, the government-owned bank Kommunalkredit Austria was sold to an English/Irish consortium, while the toxic assets were spun off to the bad bank KA Finanz. Prior to the financial crisis, the interest of private equity funds in Austrian financial institutions was obviously substantially higher, with the acquisition of the union bank BAWAG by Cerberus. BAWAG is expected to be auctioned soon.

TARGETS IN THE PACKAGING INDUSTRY

French Wendel Group acquired Constantia Flexibles, which is specialised in packaging solutions for the human and pet food production, pharmaceuticals, and beverage industries, through an auction process with the participation of many large private equity players such as Blackstone, Cinven, CVC or EQT from One Equity Partners (OEP) and former shareholder H. Turnauer Stiftung for approximately €2.3 billion (equal to approximately 9x EBITDA; leverage in that transaction amounted to approximately 5x EBITDA, in line with current market trends for comparable assets), after an IPO attempt of Constantia Flexibles in Frankfurt failed in 2013 due to unsatisfactory pricing. The appetite of private equity investors was already reported in anticipation of the contemplated IPO, but OEP preferred the public exit at first. In Q3/2014 OEP successfully sold the packing company Duropack, acquired from the Turnauer family; British packing company DS Smith purchased it for approximately €300 million. Another deal in the packing industry was the acquisition of the European tobacco packaging and general packaging divisions of MeadWestvaco to Swedish AR Packaging.

Interest in the packaging industry remained strong in 2015, but no major transaction can be reported so far.

PUBLIC BIDS

After acquiring a substantial participation in Telekom Austria in 2013 and becoming its second largest shareholder with approximately 26.8 per cent for a total investment of close to €1 billion, América Móvil and its Dutch subsidiary Carso Telecom launched a voluntary bid that then converted into a mandatory bid valued at over €1.4 billion. They now hold a majority in Austria's largest telecoms company.

América Móvil and Carso Telecom also concluded a shareholders' agreement with the state holding company ÖIAG, and participated in a share capital increase valued at €1 billion, in the context of which the Austrian Takeover Commission issued interested rulings on the applicability of pricing rules under the Austrian Takeover Act in relation to newly subscribed shares.

The increase in partial takeover bids was also notable. These aim to stay below the formal control threshold of 30 per cent (unless lowered in the articles of association as implemented by several Austrian companies), which triggers a mandatory bid obligation for all shares in the target, or are even limited to only 26 per cent, which is the ex-lege cap of exercisable voting rights (unless another shareholder hold voting rights in excess of that threshold or a bid is launched). Airports Group Europe launched a voluntary public bid to acquire 29.9 per cent in Flughafen Wien AG, the operator of Vienna International Airport, and successfully completed to hold shares just below the 30 per cent threshold, with those above 26 per cent being dormant. Similar bids were launched for real estate companies (see above).

In 2014 and 2015, we have seen more purchasers aiming for public-to-private transactions. The purchaser typically launches a voluntary takeover bid aimed at control conditional upon the acceptance of shareholders holding at least 90 per cent of the company's shares. If successful, a squeeze-out of the remaining minority shareholders follows. Minority shareholders cannot block the squeeze-out but can request a compensation review. If the squeeze-out is done following a takeover offer no later than three months following the end of the offer period, there is a rebuttable presumption that the compensation is adequate if it amounts to the highest compensation paid during the offer period. Sastre Holding launched a mandatory bid for all shares in the sparkling wine producer Schumberger AG, after already owning a participation of more than 80 per cent of the voting rights, but did not manage to secure the 90 per cent necessary for a squeeze-out of the remaining minority shareholders. Sastre purchased initial participation in Schlumberger from German company Underberg in mid-2014.

OTHER NOTEWORTHY TRENDS

In the distressed field, there was less activity than in 2013 (then mainly in relation to the €2.6 billion bankruptcy of Austrian construction company Alpine). One trend to continue from 2013, however, was that of bank-driven restructurings that resulted in the auctioning of non-core or non-performing assets. In most cases, these restructurings related to the retail sector. One example was the DIY-retailer Baumax with bank-driven sales transactions in 2014 and ongoing, or the sale of the listed office furniture specialist Bene to two Austrian private investors in mid-2015.

Capitals markets activity, on the other hand, increased again. In 2014, the capital increase of Raiffeisen International for approximately €2.75 billion was the third largest in Austrian history. Substantially smaller were the IPOs of, for example, Cross Industries in 2015, when Pierer Industrie placed up slightly less than 20 per cent to the public; or, in 2014, when Austrian aircraft supplier FACC was listed with former sole shareholder Aviation Corporation of China keeping a majority.

Some further other noteworthy deals include pharmaceutical giant Roche's acquisition of Austrian biotech company Dutalys for more than $450 million (including the variable purchase price elements). Baxter, meanwhile, sold its vaccine division for approximately €470 million to Pfizer. The €130 million acquisition of Bâloise's Austrian subsidiary Basler Versicherungs-Aktiengesellschaft by Swiss insurer Helvetia was another prominent financial industry deal.

Another industry joint venture was established in 2014 by Mitsubishi Heavy Industries taking over 51 per cent in Austrian VAI Metals Technologies from Siemens. Rather unusual was the transaction, in which Shanghai-listed crane company Sany Heavy Industries and the listed Austrian crane company Palfinger entered into cross shareholdings of 10 per cent each. B&C Industrieholding expanded its stake in AMAG to now hold a majority in the listed aluminum company, for which it already launched a public bid in 2013. Oleg Deripaska's Basic Element again increased its stake in the construction company Strabag to plus 25 per cent, after it had to decrease the stake during the financial crisis.

LEGAL AND REGULATORY FRAMEWORK

Experience shows that certain limitations under Austrian corporate law often come unexpected for foreign investors when structuring a deal, particularly its financing and intra-group transactions after consummation of the transaction: Austrian law generally prohibits the return of equity to shareholders (ie, upstream and side-stream transactions) of both a limited liability company and a stock corporation (and are applied by the Austrian courts by analogy to limited partnerships with only a limited liability company or stock corporation as unlimited partner). Based on this principle, Austrian courts have established that a company cannot make any payments to its shareholders outside arm's length transactions except in the following instances: for the distributable balance sheet profit; in a formal reduction of the registered share capital; or for the surplus following liquidation.

The prohibition on return of equity covers payments and other transactions benefiting a shareholder where no adequate arm's length consideration is received in return. To the extent a transaction qualifies as a prohibited return on equity, it is null and void between the shareholder and the subsidiary (and any involved third party if it knew or should have known of the violation). It may result in liability for damages. Most of the above principles are also applied by the Austrian courts by analogy to limited partnerships with a limited liability company or stock corporation as (the sole) unlimited partner.

Austrian courts have developed case law suggesting that a subsidiary may lend to a shareholder, or guarantee, or provide a security interest for a shareholder's loan if it receives adequate consideration in return; or if it has determined (with due care) that the shareholder is unlikely to default on its payment obligations, and that, even if the shareholder defaults, such default would not put the subsidiary at risk, and that the transaction is in the interest of the Austrian subsidiary (corporate benefit).

In addition, the Austrian Stock Corporation Act prohibits a target company from financing or providing assistance in the financing of the acquisition of its own shares or the shares of its parent company (irrespective of whether or not the transaction constitutes a return of capital). It is debated whether this rule should be applied by analogy to limited liability companies. Transactions violating this rule are valid but may result in liability for damages.

Another area in which capital maintenance problems may arise is that of deal and management fees charged by private equity funds to the Austrian target. Again, the arm's length standard is relevant to determine the compliance with Austrian law.

Furthermore, (foreign) ownership restrictions are another area of interest to many investors (note the relatively low merger control thresholds in Austria).

In regulated industry sectors (eg, banking, insurance, utilities, gambling, telecoms or aviation) the acquisition of a qualified or a controlling interest is typically subject to advance notification to, or approval of, the competent regulatory authority. Sanctions for failure to notify or obtain approval in advance range from monetary penalties to a suspension of voting rights or a partial/total shutdown.

The acquisition of ownership and certain lease interests in real estate by non-EEA nationals or the acquisition of control over companies owning such interests is subject to notification or approval by the local Real Estate Transfer Commission. What interests are covered and whether notification or approval is required varies among the legislation of the nine states in Austria. Where the real estate is used for commercial rather than residential purposes approvals are usually granted.

Under the Foreign Trade Act, the acquisition of an interest of 25 per cent or more, or a controlling interest in an Austrian business by a foreign investor (for purposes of this law, that is an investor domiciled outside of the EU/EEA and Switzerland; if the investor is resident in that region, no advance approval is required, but ex officio investigations can be initiated without time limit) is subject to advance approval by the Austrian Minister of Economic Affairs where that business is involved in internal and external security (for example, defence and security services) or public order and security, including public and emergency services, such as hospitals, emergency and rescue services, energy and water supply, telecommunications, traffic or universities and schools. Transactions subject to approval cannot be completed pending approval. Failure to obtain approval is subject to imprisonment and criminal penalties.

FUTURE DEVELOPMENTS

The outlook for the rest of 2015 is rather difficult due to macroeconomic developments (eg, Grexit) that may change the current investment environment in Europe and internationally. Generally, the first half of 2015 was active, based on the assumption that the Austrian M&A market continues its strong performance. This is also supported by the fact that, in particular, private equity hold substantial cash reserves to be invested and many of their portfolio companies are overdue to be sold again.