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→ Takeover of listed companies

When taking over companies whose shares are admitted to trading on an organised market (public takeovers), the detailed regulations of the German Securities Acquisition and Takeover Act (WpÜG) must be observed. The main aim of the WpÜG is to provide a framework ensuring transparency and to prevent unregulated takeovers. Public in this context means that acquisition offers are not directed at individual shareholders but at a large, undefined group of addressees.

The following article provides an overview of the main terms used in the WpÜG in connection with public takeovers and generally outlines the process of a public takeover.

Types of offers

The WpÜG distinguishes between voluntary offers (takeover bids and other acquisition offers) and mandatory offers.

Takeover bids are required if a bidder intends to acquire a controlling position in the target company for the first time. Simply speaking, a controlling position means the holding of at least 30 percent of the voting rights in the target company by a shareholder. If several shareholders act jointly and in concert, the number of their voting rights must be added together (acting-in-concert). This also applies to other acquisition offers and mandatory offers.

Other acquisition offers are deemed to exist if a bidder either intends to acquire for the first time through a public initial offering a holding of less than 30 percent of the voting rights in the target company or to increase his already existing controlling position in the target company. A special case of the other acquisition offer is the delisting acquisition offer, in which the bidder seeks the revocation of the admission of the target company to the stock exchange (delisting).

A shareholder or a majority of shareholders (acting in concert) is obliged to make a mandatory offer if he has/they have acquired control of the target company in another way, i.e. not by means of a voluntary offer.

Timeline of a public takeover

The bidder must publish without undue delay his decision to make a voluntary offer or, once control of the target company has been acquired, his obligation to do so.

Within a maximum of eight weeks after the publication, the bidder must submit an offer document to the Federal Financial Supervisory Authority (BaFin). The offer document serves as a source of basic information concerning the acquisition offer for the shareholders in the target company. If, after successful examination, BaFin allows the bidder to make the offer, the offer must also be published without undue delay. By publishing it, the bidder makes a binding offer to the shareholders in the target company to acquire the shares held in the target company.

As regards the form and content of a public offer, the bidder must comply with mandatory provisions of the WpÜG.

Consideration

The consideration offered by the bidder must be adequate and may not fall below the minimum value set by law. In the case of a takeover bid, the consideration must at least correspond to the average domestic stock exchange price of the shares in the target company over the three months preceding the publication of the decision. In the case of a mandatory offer or a delisting acquisition offer, the period is six months. There is no minimum price for other acquisition offers. It should be noted that for all types of offers, the consideration does not necessarily have to be paid in cash, but can also take the form of stock awards.

Conditions

The bidder may not arbitrarily determine conditions regarding the offer. Permissible are only conditions the meeting of which cannot be caused exclusively by the bidder himself. The permissible conditions thus include, for example, the achievement of certain minimum acceptance thresholds or obtaining official approvals. In the case of delisting offers, it should be noted that they may not be tied to any conditions whatsoever.

Acceptance periods

The period for shareholders to accept an offer can be four to a maximum of ten weeks. When the acceptance period expires and the concluded transfer agreements are fulfilled, the takeover procedure under the WpÜG generally ends.

Exceptions apply, for example, to voluntary offers. In this case, the bidder can

extend the offer period once by a further two weeks relying on the so-called "Zaunkönigregelung" rule (the name of the rule was inspired by the bird called *Zaunkönig* which is German for wren) after he has published the new number of voting rights he holds.

Another exception applies if the buyer acquires further shares in the target company over the counter within one year of the expiry of the acceptance period (subsequent acquisition). If the consideration granted for these shares exceeds the consideration specified in the offer, the bidder is generally obliged under the WpÜG to pay the difference to the shareholders who have accepted the public offer.

Squeeze-out

If, after completion of the takeover procedure, the bidder holds at least 95 percent of the voting rights in the target company, the remaining minority shareholders can be excluded from the company through a squeeze-out procedure. The procedure of the German Stock Corporation Act as modified by the WpÜG has mainly the advantage that – if a takeover bid involves a squeeze-out – no resolution of the general meeting is required. Minority shareholders can therefore be excluded by court

order upon request. Furthermore, the compensation to be paid to the excluded shareholders may under certain circumstances be equal to the takeover price arising from the public offer. This eliminates the need for conducting an often very expensive company valuation procedure to determine the amount of compensation.

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→ Cross-border sale of real estate companies

Many double tax treaties (DTTs) concluded by Germany contain a provision assigning Germany the taxation right on profits from the sale of foreign company shares, whose value is (in)directly derived from more than 50 percent on real estate located in Germany. However, in the absence of a comprehensive national taxable event, Germany could only exercise this taxation right if the company concerned had its statutory seat or effective place of management in Germany. In particular, Germany could not, for example, impose taxes on transactions involving the sale of shares in a Luxembourg company owning real estate in Germany, either directly or through a German real estate company, even though the taxation right was allocated to Germany under the

applicable DTT. The legislator addressed this regulatory gap by introducing a new provision (Sec. 49 para. 1 no. 2 lit. e) cc) in the German Income Tax Act (ITA).

Legal situation since 1 January 2019

Since 1 January 2019, domestic income subject to a limited tax liability is assumed under the new provision, if the following criteria are met:

- The taxpayer (in)directly held at least 1 percent of the shares in a company with its statutory seat and effective place of management abroad within the last five years prior to the sale of its shareholding.

– At any time during the last 365 days prior to the sale, more than 50 percent of the value of the shares in the foreign company was (in)directly derived from real estate located in Germany and the seller was (at least) the beneficial owner of the shares at that time. However, the taxpayer is not required to have held at least 1 percent of the shares in the company at the relevant point of time. When determining the 50 percent threshold, it is irrelevant whether the domestic real estate is owned by the company itself or by its (sub-)subsidiaries.

In order to examine whether the criteria are met, the value of the domestic real estate needs to be assessed in relation to the value of the company's total assets. In this regard, the 50 percent threshold is to be determined based on the book values of the assets at the time of disposal. For this purpose, the book values of the assets recognized in the latest balance sheet have to be carried forward to the date of disposal. Liabilities (e.g. bank debts) are not considered when determining the relevant threshold. In case the company only indirectly owns domestic real estate through one of its subsidiaries, the 50 percent threshold must be determined on a consolidated basis.

Practical information

According to most DTTs signed by Germany, the 50 percent threshold only needs to be met at the time of disposal (and not at any time during the last 365 days prior to the sale like in case of Sec. 49 para. 1 no. 2 lit. e) cc) ITA). Therefore, companies may change their asset structure shortly before the sale of shares in a manner ensuring that the 50 percent threshold is not exceeded. Consequently, it could be avoided that the respective DTT allocates the taxation right on the capital gains to Germany. Since the provisions of a DTT generally take precedence over national tax regulations, Sec. 49 para. 1 no. 2 lit. e) cc) ITA could not apply in such cases.

Furthermore, it should be noted that there is considerable potential for tax planning

even if Sec. 49 para. 1 no. 2 lit. e) cc) ITA applies, as the relevant 50 percent threshold is determined on the basis of the book values (not on the basis of the fair market values, which may differ significantly) of the company's assets and as liabilities are not taken into account.

Moreover, according to a judgement enacted by the Federal Fiscal Court (BFH), any capital gains taxable under Sec. 49 para. 1 no. 2 lit. e) cc) ITA should be 100 percent tax exempt if the seller is a foreign company.

Conclusion

Although the legislator has closed a regulatory gap by introducing Sec. 49 para. 1 no. 2 lit. e) cc) ITA, there is still considerable potential for tax planning. Therefore, taxpayers contemplating a cross-border sale of real estate located in Germany should assess possible exit strategies at an early stage of the sale process.

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→ The earn-out arrangement – an aid for uncertain times

By means of an earn-out clause in the company acquisition agreement, the parties agree to pay part of the purchase price not at the time of the transfer of the shares but at a later date. Earn-outs thus divide the purchase price into two components: the fixed component, which is payable upon closing, and the variable component, which the seller only receives at a later date after closing, provided that the acquired company achieves certain pre-defined goals. The earn-out phase being the period between closing and the payment of the earn-out component of the purchase price is generally 2-5 years. Earn-out arrangements are often made part of the purchase price,

- if the seller retains a minority interest in the company and/or a key position with significant influence on the economic development of the company and the earn-out arrangement can thus significantly contribute to increasing the interest of the seller in a future positive development of the company, or;
- if the seller and the buyer have significantly differing estimates of the future development of the company's profitability and, in this respect, the basis for determining the purchase price. As the buyer usually does not consider it realistic that the improvement in the economic and financial situation of the target company planned by the seller will be achieved and can therefore already be reflected in the (fixed) purchase price at the time of closing, the buyer is often initially not willing to take this into account in the purchase price. However, the buyer is often willing to pay a correspondingly higher (total) purchase price if the company develops as forecasted by the seller.

Basis for calculating an earn-out

The earn-out is usually calculated on the basis of EBITDA as the benchmark. It is also possible to calculate the earn-out based on other income statement indicators such as EBIT, sales revenue or net profit. In addition to specifying a benchmark, the parties should agree to adjust individual items. In this respect, during the negotiations, it is advisable to define as closely as possible a list of issues to be covered by such an agreement in order

to reduce the risk of later disputes as much as possible. In order to determine a long-term EBITDA, normalization issues typically identified during financial due diligence can be used as a frame of reference, such as company-specific issues, certain legal disputes, warranty, employee severance payments, site closures or the loss of certain customers or orders. The parties should also agree how, for example, extraordinary income and expenses (e.g. compensation, legal disputes, sale of fixed assets) should be taken into account.

The aim of the adjustments is to reflect the original performance of the target company and thus to reconcile differing expectations of the seller and the buyer regarding the value that have not been resolved during negotiations based on arrangements previously made by the parties. Furthermore, this should also limit the possibilities for opportunistic behaviour on the part of the buyer.

Establishment of accounting standards

In addition to the precise definition and clarification of the benchmarks, the applicable accounting standards should also be specified. It should also be ensured that the accounting standards are applied consistently throughout the entire period covered by the calculation. They should also be consistent with the standards applied during the financial due diligence period. Should individual standards change during the period covered by the calculation, e.g. the classification of lease transactions (finance lease instead of operating lease, i.e. once recorded as depreciation and interest expense instead of other operating expenses), this should be adjusted accordingly for the purpose of adjusting the purchase price.

Conclusion

In M&A transactions, earn-outs can help to bridge differing expectations of the buyer and the seller regarding the price. However, it should always be ensured that very detailed and specific arrangements, on the basis of which the earn-out is calculated, are included in the purchase agreement. This can reduce the risk of conflict between the buyer and the seller.

For the buyer, earn-out arrangements are advantageous because they reduce the risk of an erroneous company valuation. Furthermore, it is advantageous for the buyer if he has to pay the (total) purchase price not upon closing but depending on the development of the company. The advantage of the seller is that he might achieve a higher (total) purchase price thanks to the earn-out.

In times of crisis, opportunities and risks involved in an M&A transaction are usually (very) differently assessed by the seller and the buyer. Therefore an earn-out agreement is an often selected instrument, especially in today's economic situation, as it is currently difficult to predict the future economic development.

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→ M&A Vocabulary – Understanding Experts

"Pro forma financial information"

In this ongoing series, a number of different M&A experts from the global offices of Rödl & Partner present an important term from the specialist language of the mergers and acquisitions world, combined with some comments on how it is used. We are not attempting to provide expert legal precision, review linguistic nuances or present an exhaustive definition, but rather to give or refresh a basic understanding of a term and provide some useful tips from our consultancy practice.

Although there is no fixed definition of *pro forma financial information*, it is usually understood as a set of figures that are not based solely on actual accounting data (such as the figures in the financial statements) but have been adjusted to reflect a particular assumption or scenario. Such pro forma information is presented to show underlying trends and/or to show information that can be used as a basis for comparing future developments.

Among other things, pro forma adjustments are made to present the impact of changes made during the year on the full-year result: pro forma figures then present the performance of the business as if the new situation had already existed from the beginning of the year. They are often used, for example, when expanding a business, such as when buying a branch or a factory: pro forma adjustments represent the effect of such change on the full-year results of the business as if the acquisition had already taken place at the beginning of the year, thus providing a basis for comparison for future periods. For this, income and expenses of the new branch from the beginning of the year until the date of the acquisition are added to the values from the accounting system in which the new branch has only been recorded since the transfer of ownership. In most cases, such retroactive pro forma adjustments are made not only for the period concerned but also for the previous period(s) to enable comparing the performance of today's business over time (the so-called like-for-like basis). Other frequent like-for-like adjustments include the elimination of financial information for a discontinued product group or markets no longer served, or lost or won customers.

In addition to such like-for-like adjustments made to reflect changes in business volumes, pro-forma adjustments may also be

forward-looking. For example, pro forma adjustments are made in the case of companies whose growth strategy is to open new branches rather than to acquire existing branches. In this case, the results of such fledgling branches, which first will be low as such branches are first in the start-up phase, will be replaced with extrapolated results that correspond to the full growth stage (the so-called "run rate"), for example by using results of comparable branches that have already successfully completed the start-up phase.

Pro forma adjustments may also be made to eliminate effects of extraordinary (i.e. non-recurring) events. In the case of many companies, the coronavirus crisis can be considered as such an extraordinary event: for example, for a fast food chain that had to close some of its branches due to the lockdown, a pro-forma adjustment might be a good option where the figures for these branches for the weeks and months affected by the lockdown (they recorded no sales but costs at the same level or only slightly lower than before) are replaced with the figures for the corresponding period of the previous year or by the figures for comparable branches which are not affected by the lockdown. Such pro forma information shows an "as if" scenario, which may provide a basis for assessing and estimating future developments better than the results significantly impaired by the lockdown that will be presented in the actual annual financial statements for 2020 (unless long-term coronavirus effects and another lockdown are expected).

When preparing pro forma financial information, it is important to also eliminate one-time effects arising from the same event as the adjustment itself, even if such one-time effects may have occurred outside the adjustment period itself. In the example of the fast-food chain and the adjustment of the lockdown effect, such one-time effects would be, for example, lower back bills for

electricity or the receipt of short-time work benefits or other state aid.

Finally, pro-forma adjustments can also be made to eliminate one-time effects arising from changes in accounting standards or accounting choices. As with like-for-like comparisons, this involves adjusting financial information for the current and previous periods as if the new standard or the choice had always been applied.

CONCLUSION

When correctly applied, pro forma figures can help assess and compare a company's historical and future performance of a business. It is important to ensure that all pro forma adjustments are clearly marked as such and that the adjustment procedure is clearly explained. In this way, the respective addressee can see that the presented figures are not the figures disclosed in the actual annual or quarterly financial statements, and how the figures have been changed or what elbow room the preparer of the pro forma figures had.

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