The 2011 guide to

Capital raising

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Making the most of it

The capital markets team at Niederer Kraft & Frey discusses the legal framework for capital raising in Switzerland

Amid continuing economic uncertainty following the global financial crisis, the recovery of the Swiss economy continues and Switzerland seems to be emerging less bruised than many other developed economies. While the Swiss market has seen a limited number of successful IPOs recently, Switzerland-listed companies have raised over SFr3.1 billion ($3.7 billion) in secondary equity offerings in 2010 and the first half of 2011.

Due to large secondary equity offerings by Swiss banks during the financial crisis, this does not constitute an increase in terms of total volume but rather a qualitative change as the improved market environment meant that most equity offerings were not to repair balance sheets, but rather to finance growth and acquisitions. Issuers with a strong equity story were able to offer new shares without discount in so called at-market rights offerings.

Pre-emptive rights and types of capital

Under the Swiss Code of Obligations (CO), new share capital can be created by way of ordinary, authorised or conditional capital increase (for a discussion of new types of capital for banks in connection with proposed rules for systemically important financial institutions, see below). All types of capital require, at some point in time, shareholders' approval at a shareholders' meeting, which must be called at least 20 days in advance. Table one sets out the main features of each type of capital increase.

Swiss corporate law gives pre-emptive rights to shareholders with respect to any issuance of equity or equity linked debt instruments. A company that raises capital must therefore offer existing shareholders the opportunity to subscribe for new shares or equity-linked instruments in proportion to their shareholdings. Compared to many other jurisdictions there is no threshold size (for example 10%) below which shareholders do not have pre-emptive rights.

Pre-emptive rights can be excluded by shareholders with a majority of at least two-thirds of the votes and an absolute majority of the nominal value of the shares represented at the shareholders' meeting.

In addition to this supermajority, the CO requires a valid reason for the cancellation of pre-emptive rights and adherence to the principles of equal treatment of shareholders and considerate exercise of rights.

A valid reason to exclude pre-emptive rights requires an objective and justified interest of the Company issuing the shares. Generally accepted as valid reasons are, for example:

(i) M&A transactions and employee participation (specifically mentioned in the CO as examples of valid reasons);

(ii) under certain conditions, welcoming a new strategic investor to help fund growth or fend off a takeover offer deemed insufficient by the board; and

(iii) recapitalisation in financial distress, for example by way of debt-for-equity swap, the issuance of mandatory convertible securities or where an investor can only be found when offering a substantial shareholding.

Whereas in an ordinary capital increase the shareholders themselves exclude the pre-emptive rights, by creating authorised capital the shareholders delegate the decision to exclude pre-emptive rights to the board. In a non-pre-emptive capital increase from authorised capital, the board must, therefore, decide to exclude the pre-emptive rights on the basis of the authorised capital in the articles of association that must authorise the board to do so and state a valid reason for such an exclusion.

Because a cancellation of pre-emptive rights may constitute a major impairment of the existing shareholders' rights in the company, the board must also adhere to principles of equal treatment of shareholders and considerate exercise of rights. Failure to do so may expose the board to liability.

> "Due to statutory pre-emptive rights, most secondary equity offerings in Switzerland are rights offerings"

Whether shareholders can give the board maximum flexibility by authorising the exclusion of pre-emptive rights to take advantage of favourable conditions on the capital markets on short notice is unclear. An objective reason for such exclusion would be that it would allow a company to raise equity at relatively low cost, for example by way of a private investment in public equity (Pipe) transaction.

Private placement safe harbour

Because Swiss law does not have a clear statutory private placement safe harbour, there is considerable uncertainty as to when an offering of new shares is considered an offering to the public and thus subject to the prospectus requirements discussed below. Article 652a CO simply states that any offering is public "unless addressed to a limited group of persons". In the absence of a quantitative threshold and an exemption for qualified investors, what that means exactly has been extensively debated in Swiss doctrine.

The most restrictive view is that any offer made to more than 20 investors is deemed a public offer. While certain authors advocate an increase of this statutory threshold to up to 100, others take the view that any offer to a group of persons limited by an objective common criterion, an offer to existing shareholders or employees, for example, should not be deemed a public offer. Other authors take the view that an offer to so-called qualified investors (as defined in the Swiss Federal Statute on Collective Investments) should not be considered a public offer. This view is supported by the fact that Swiss law includes private placement safe harbours for investment funds and structured products. A proposed amendment of the CO would include a qualified investor exemption for equity and debt offerings as well. In the absence of a private placement safe harbour, however, each offering must be evaluated on a case-by-case basis, weighing all the relevant facts.

> "Because Swiss law does not have a clear private placement safe harbour, each offering must be evaluated on a case-by-case basis"

Prospectus requirements

Switzerland is not an EU Prospectus Directive (PD) jurisdiction and Swiss law prospectus requirements, when securities are offered to the public or admitted, to

Table one: main features of capital increases

	Ordinary capital art. 650 CO	Authorised capital art. 651 CO	Conditional capital art. 653 CO
Shareholders' resolution	Shareholders resolve on terms of capital increase and instruct board to increase capital. Fixing of issue price (and in limited circumstances also the number of shares) may be delegated to board.	Shareholders amend the articles of association to include authorised capital to authorise board to issue a maximum amount of shares.	Shareholders create unissued share capital for - equity-linked debt, - bonds with warrants, or - employee stock options by amending the articles of association. New share capital will be created by operation of law upon conversion/exercise of options.
Maximum volume	unlimited	up to 50% of existing share capital	up to 50% of existing share capital
Validity	3 months from shareholders' resolution	2 years from shareholders' resolution	Unlimited
Pre-emptive rights	✓	✓	✓
Exclusion of pre-emptive rights	Shareholders may exclude pre-emptive rights for valid reasons	Shareholders may authorise board to exclude pre-emptive rights for stated valid reasons upon issuance of the authorised shares	Shareholders may exclude pre-emptive/subscription rights for stated valid reasons
Contribution in kind	✓	✓	✘
Majority requirements	majority of votes represented at shareholders' meeting	two-thirds of the votes and majority of nominal value of shares represented at the shareholders' meeting	two-thirds of the votes and absolute majority of nominal value of shares represented at the shareholders' meeting
Advantages/ Disadvantages	+ No size limitation - Minimum 20-day period for convening necessary shareholders meeting - Board has less flexibility	+ No shareholders' approval required at time of issuance of the shares + Flexibility of the board to determine timing, offer size and issue price + Shareholders cannot challenge withdrawal of pre-emptive rights upon issuance if made within the authorisation - Potential liability of the board when setting terms of issuance	- Limited purpose + No shareholders' approval required at time of issuance of the shares + Flexibility of the board to determine timing, offer size and issue price + Shareholders cannot challenge withdrawal of pre-emptive rights upon issuance if made within the authorisation

Table two: Equity Cash Financings of SIX-listed Swiss companies (Jan 2010 – June 2011)

Issuer	Size in SFr and type of offering	Purpose of offering	Date
MCH Group	40 million discounted rights offering	Finance construction project	May 2011
Kuoni	257 million discounted rights offering	Refinance debt	May 2011
Clariant	368 million at market rights offering	Finance acquisition of Süd-Chemie	April 2011
Schmoltz+Bickenbach	131 million discounted rights offering	Refinance Debt	April 2011
StarragHeckert	67 million at-market rights offering	Refinance Debt and finance acquisition	April 2011
Leclanché	31 million discounted rights offering	Expand cell production	Dec 2010
gategroup	252 million at market rights offering	Finance growth	Nov 2010
Schmoltz+Bickenbach	297 million discounted rights offering	Refinance Debt and improve financial flexibility	Nov 2010
Orascom	185 million discounted rights offering	Finance current development projects	Oct 2010
Aryzta	140 million non-pre-emptive cash placing	Finance acquisition of FSB	June 2010
Petroplus	151 million non-pre-emptive cash placing	Finance acquisitions	May 2010
OC Oerlikon	1 billion discounted rescue rights offering	Refinance debt and finance investments	May 2010
Allreal	225 million discounted rights offering	Finance acquisition of real property	May 2010

Table three: Features of at-market and discounted rights offerings

	At-market rights offering	Discounted rights offering
Pricing	• Subscription period starts without publication of subscription price • Maximum subscription price can be set to provide investors with some price guidance • Subscription price will be set after rump placement on the back of a book-building process: In most cases, a book-building process (global offering) is started parallel to the subscription period • Subscription price will be set within a certain range of the market price of the shares, typically not above or below 5% of the market price on the day before the pricing date.	• Subscription price set before subscription period at a (significant) discount
Rights trading	✘	✓
Take-up	Significantly lower than deep discount rights issue, typically approximately 40-50%.	Approximately 95 to 100%.
Advantages/ disadvantages	+ Maximises proceeds per share; minimises dilution per share + Strong signalling message to markets regarding share value + Simultaneous book-building allows more effective targeting of new investors - Increased transaction risk due to larger rump and lack of floor price - Final proceeds certain only after bookbuilding – early stage underwriting difficult to achieve	+ Certainty of proceeds at launch + Rights have intrinsic value encouraging shareholders to take up their rights and avoid dilution or sell them - Discount leads to greater dilution on per share basis in the event existing shareholders decide not to fully participate - Greater exposure to arbitrage funds
Required success factors	• Positive market environment • Strong equity story • Issuer issuing from a position of strength	• Commit major holders to the extent possible to subscribe

trading differ from jurisdictions where the PD applies.

Article 652a CO requires an offering prospectus when new shares are offered to the public in Switzerland and also contains certain disclosure items that must be included. The offering prospectus must be made available to investors but is not subject to any filing or approval requirements with any Swiss regulator. A breach of the CO prospectus requirements may, however, result in prospectus liability.

With the exception of the requirement to include the most recent unconsolidated statutory financial statements of the issuer, the CO disclosure requirements are not particularly demanding and a PD compliant prospectus generally contains the minimum disclosure requirements of the CO.

If shares are listed on a stock exchange in Switzerland, the respective listing rules apply. The listing rules of SIX Swiss Exchange, Switzerland's main stock exchange, for example, are largely modelled after the PD, but are less extensive and more flexible. For a discussion of the SIX prospectus approval process and prospectus-free rights offerings, see below.

Swiss issuers that list shares on SIX prepare a prospectus that complies with both the SIX Listing Rules and the CO prospectus requirements (a so-

called Offering and Listing Prospectus). The question whether or not a prospectus complies with the CO prospectus requirements is also relevant for non Swiss issuers offering shares to the public in Switzerland, but not listing shares on SIX. Typically, additional disclosure items required, if any, will be included in a Swiss wrapper or in the prospectus.

According to prevailing doctrine, article 652a CO is not applicable to offerings of existing shares. Accordingly, an offer of existing (treasury) shares by the issuer (or a shareholder) do not trigger an article 652a CO offering prospectus requirement. Nevertheless, undocumented sales of existing shares are typically made by way of private placements.

The SIX Listing Rules require that an approved prospectus be published before shares are admitted to trading on the SIX. The SIX prospectus review and approval process takes 20 SIX trading days.

In practice the approval process is timed such that SIX approval has been obtained before printing of the prospectus and the start of the subscription period. Generally, the SIX prospectus approval process is less onerous than in most EU jurisdictions and the US. For example, amended drafts of the prospectus may be filed within the 20-day review period without an adverse effect on timing; also, the review by SIX is generally limited to a rule check.

Date
May 2011
May 2011
April 2011
April 2011
April 2011
Dec 2010
Nov 2010
Nov 2010
Oct 2010
June 2010
May 2010
May 2010
May 2010

Structuring considerations

Rights offerings and non-pre-emptive placements

Due to statutory pre-emptive rights, rights offerings in Switzerland are not limited to troubled or distressed companies but most secondary equity offerings in Switzerland are rights offerings. The most common form of rights offerings in Switzerland are traditional rights offerings, where a company raises capital by offering existing shareholders the opportunity to subscribe for new shares in proportion to their shareholdings, under the same terms as each other investor.

Where companies need to raise funds more quickly and with more certainty as to the funds that will be in place at a certain point in time, Swiss companies typically place shares sourced from authorised capital with institutional investors in a non-pre-emptive placement by way of accelerated bookbuilding. Rights offerings that are structured as a two-stage process with an accelerated institutional and a secondary retail tranche and other types of accelerated rights offerings are uncommon in Switzerland. While also uncommon in the Swiss market, companies that require more certainty as to funds may rely on volume underwriting or backstop commitments from underwriters or third parties.

Table two sets out the largest secondary market transactions of SIX listed issuers in 2010 and the first half of 2011.

Prospectus-free and short-form prospectus offerings

For rights offerings, where shares are listed on SIX, the SIX Listing Rules require publication of a listing prospectus, which is not substantially different in content to what is required in an initial public offering. There are certain exemptions that allow the listing of prospectus-free rights offerings, for example if the shares offered in the rights offering account for less than 10% of the shares (including conditional capital) of the issuer already listed. The SIX Listing Rules do not include a proportionate disclosure regime for pre-emptive rights offerings as proposed in the Prospectus Directive amendments adopted by the European Council in October 2010.

> "The availability of authorised capital is a key timing factor"

It is important to note that exemptions under the SIX Listing Rules do not apply to the requirement to publish a CO-compliant offering prospectus discussed above; if the new shares are offered to the public in Switzerland (see definition above) a CO-compliant offering prospectus is required even if no SIX listing prospectus would be needed.

Discounted v at-market

Where new shares are offered at a discount to current market price, the (nil paid) rights of the shareholders to subscribe for the new shares are typically tradable so that shareholders that are unable or unwilling to exercise their rights can realise some value as a compensation for the dilution of their shareholdings.

In the absence of financial distress, discounts may not exceed 33 1/3% as higher discounts may be qualified as taxable distributions under Swiss tax laws. If market conditions are such that a deep discount to current market price is required to attract investors, it is advisable to seek a tax ruling in advance of the rights offering to avoid adverse tax consequences. A tax ruling typically takes two to four weeks from filing until grant.

Recently, issuers with a strong equity story have been able to use the positive market environment to conduct rights offerings without discount. Because the rights allocated to shareholders in these so called at-market rights offerings have no intrinsic value, there typically is no trading of these rights.

Table three compares the main features of at-market and discounted rights offerings.

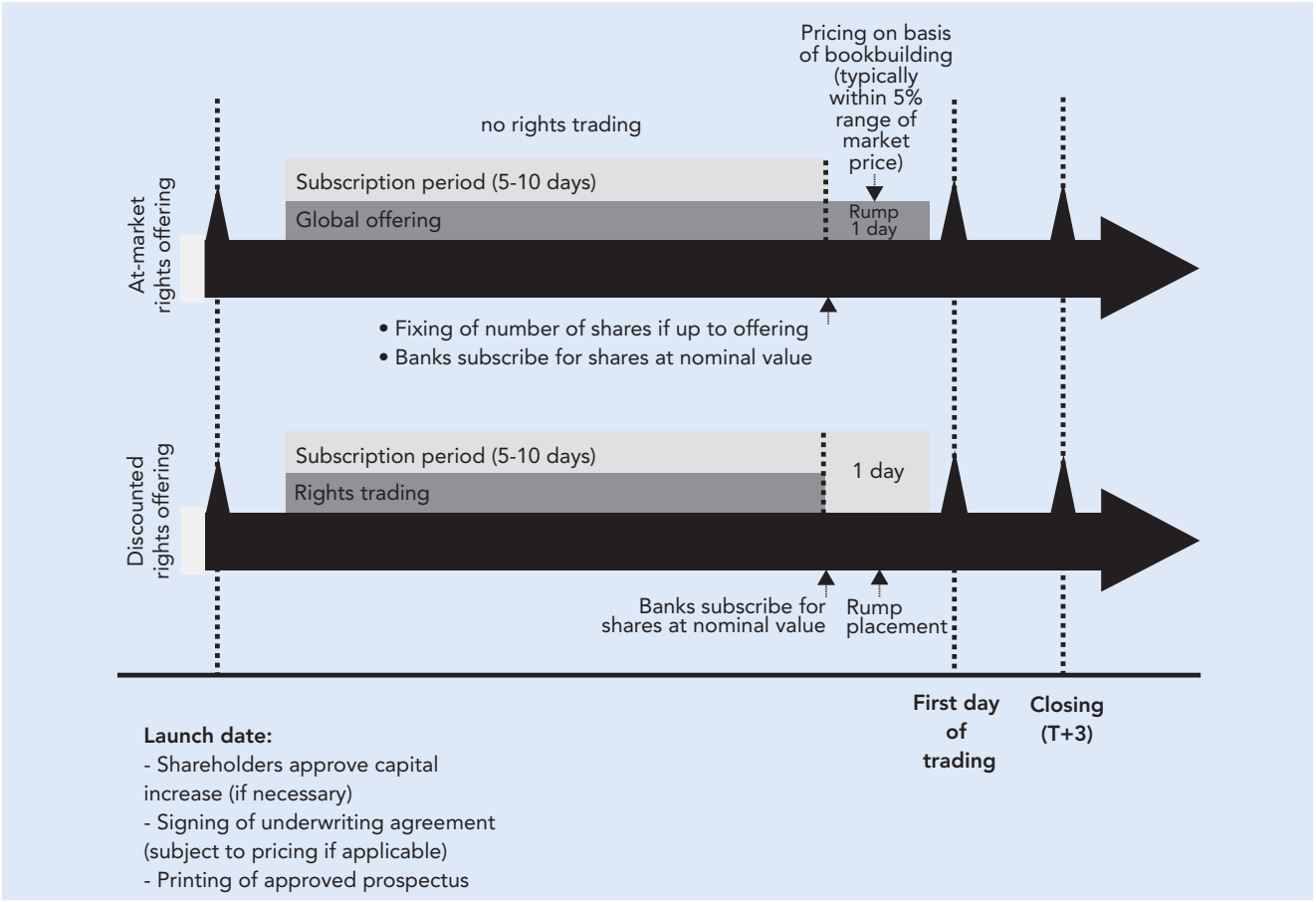
Timing considerations

There are no rules on how long the rights offer period must last. Market practice is for the rights offer period to be between five and 10 SIX stock exchange days. If a shareholders' meeting is required to create the new shares offered, the rights offer period typically does not start until the necessary shareholder approvals have been obtained.

Because a shareholders' meeting must be called at least 20 days in advance, the availability of authorised capital that allows the board to issue shares without shareholder approval is a key timing factor.

Under Swiss law, shares only come into existence upon registration of the capital increase with the competent commercial registry. This, in combination with the fact that SIX requires the delivery of a certified excerpt from the commercial registry evidencing registration of the capital increase, before start of trading, makes it necessary to effect the share issuance (by way of payment by the underwriters of the nominal amount of the new shares and filing of a public deed with the commercial registry) before pricing (in case of an at market offering), start of SIX trading and closing (payment of offer price net of pre-paid nominal versus delivery) of the offering. Banks have become comfortable with this standard practice although it deviates from that in many other jurisdictions.

The graphs in figure four summarise typical timetables for discounted and at-market rights offerings.



They assume that - if existing authorised capital is unavailable - a shareholders' meeting has been called at least 20 days in advance and that the prospectus has been approved and can be published at the time of announcement of the rights offering (or shortly thereafter). As discussed above, the SIX prospectus review and approval process takes 20 SIX stock exchange days.

The time required for the preparation of the prospectus for initial filing with SIX varies, depending on different factors, including the issuer's experience with capital markets transactions.

New types of capital

In April 2011, the Swiss Federal Council issued draft legislation that aims at strengthening the stability of the financial system by introducing new rules for systematically important banks.

Part of the proposed new rules is the creation of new types of equity capital for all (not only systematically important) Swiss banks: reserve capital and conversion capital.

Reserve capital (*Vorratskapital*)is a new type of authorised capital, designed to give the board of a bank organised as a corporation maximum flexibility to issue new share capital at short notice in the event of a deterioration of the bank's capital base.

Conversion capital (*Wandlungskapital*) is a new type of conditional capital available for banks organised as a corporation, designed as a source of shares for contingent capital securities that convert into shares upon certain regulatory capital triggers.

While the Swiss parliament may decide on some modifications to these legislative proposals, generally, it is fair to assume that these new capital tools, together with the new Basel III capital requirements and Swiss finish rules thereto, will have a significant impact on the Swiss capital markets and capital raisings of Swiss financial institutions.