The Mergers & Acquisitions Review

Fifth Edition

Editor
Simon Robinson

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EDITOR'S PREFACE

After a prolonged period of uncertainty and decreased M&A activity, deal-making is undergoing something of a resurgence. Over the course of recent years, corporations across the world have been carefully navigating the economic downturn and attempting to consolidate their positions. In 2011 the market has proved more conducive to M&A and, at least in the first half year, confidence seems to be returning. Opportunities are seemingly limited to those companies and private equity houses that enjoy a stable financial basis. Governments have addressed the perceived failings of the regulatory framework and, for the most part, reforms have now been implemented. One of the underlying reasons for the drop in M&A was the drought of acquisition finance; without the necessary funding, few players were able to launch major takeover bids. However, the loan market appears to have gained a new lease of life and banks are adamant that they are willing and able to fuel well-conceived bids. The task that lies ahead of companies and funds is identifying truly value-generative targets and negotiating the new regulatory framework. There is increased emphasis on the views of shareholders following the financial crisis, and companies are best advised to gauge shareholder sentiment early. The provenance of M&A is undergoing a gradual shift, with deal-making in the Asia-Pacific region reaching its highest-ever level in 2010 and also representing its highest proportion of the total global value of M&A. In addition, the emerging markets are witnessing heightened deal activity, in particular the BRIC nations. These trends seem set to continue.

It would be premature, however, to suggest that M&A has completed a Lazarus-like revival. The recovery of deal-making is in its infancy and it is still highly susceptible to external forces. A number of major political and economic factors may impede sustained M&A activity, and could even force it to retreat. The sovereign debt tribulations in Europe, the weakening of the US economy, the 'Arab Spring' uprisings, the earthquake in Japan, rising commodity prices and global austerity measures all pose severe challenges. Given the fragile state of the global economy, such issues could well shackle the fledgling M&A revival. In short, economists remain uncertain about the health of M&A, and although many commentators hope that it will continue to gather pace, albeit slowly, there are a number of variables that may waylay deal-making. Economists have not ruled out short-term stagnation in deal value and volume, as a precursor to the dawning of an M&A renaissance further down the line.

I wish again to thank all the contributors for their continued support in producing this book – one would hope that in this uncertain time the following chapters should provide cause for cautious optimism, while also reiterating some of the lessons from the recent lean years.

Simon Robinson
Slaughter and May
London
August 2011

Chapter 28

HUNGARY

*Péter Berethalmi and Balázs Karsai**

I OVERVIEW OF M&A ACTIVITY[1]

In 2010, compared to 2009, M&A activity in the Hungarian market increased by 12 per cent in terms of the value of transactions with an aggregate amount of 774 billion forints. There is no significant change in the number of the transactions: while in 2009 there were 129 deals concluded, in 2010 there were 127 transactions announced.

The increase was significantly higher in case of transactions concluded by Hungarian companies abroad compared to transactions concluded in Hungary. Deals concluded in Hungary increased by 6 per cent in 2010 with the value increasing from 564 billion to 596 billion forints. In comparison, the value of transactions concluded by Hungarian companies abroad increased by 40 per cent, amounting to 179 billion forints.

Although there has been a modest recovery on the Hungarian M&A market compared to 2009, the lack of sufficient financing, the uncertain legal background and the unsteady currency suppresses the appetite of investors. In addition, Hungary has been facing continuous relegations by the international credit rating agencies.

In parallel, the access of companies to bank resources was and still is limited. Businesses faced difficulties even in securing finance for their operations; under these circumstances, financing institutions were reluctant to provide the necessary resources for high-value transactions. As a result, in 2010, in contrast to 2008 and 2009, there were no transactions exceeding the amount of 100 billion forints as far as the Hungarian market is concerned.

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1 Compiled from the following sources: M&A Navigátor 2011 február IV/1, 2011 május IV/2; portfolio.hu (www.portfolio.hu); ecoline.hu (http://ecoline.hu); and Heti Világgazdaság (www.hvg.hu).

Despite recent positive developments, the strengthening of the Swiss franc and the euro against the forint had an adverse effect on the acquisition process of Hungarian companies, first of all, because of the high ratio of credits denominated in foreign currencies.

There was a remarkable increase in the value and in the number of transactions in the fourth quarter of 2010. As a result, the aggregate transaction value in the fourth quarter of 2010 was twice as high as the average of the first three quarters of the same year, which was considered as a positive sign in the M&A trends. As to the number of deals: 46 of the 127 successful transactions were concluded in the fourth quarter. That said, in the fourth quarter of 2010 the size of the Hungarian M&A market only reached the size of the first quarter of 2008 (before the financial crisis).

Contrary to expectations, the number of transactions concluded in the first quarter of 2011 fell to the level of the first three quarters of 2010. The aggregate value of the transactions concluded in the first quarter is also distressing if one considers that 300 million forints of the aggregate 380 million forints transaction value resulted from a single deal (the completion of the acquisition of BorsodChem by WanHua, please see Section IV).

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The general legal framework that governs the restructuring of companies is set out in Chapters V and VI of the Act IV of 2006 on Business Associations ('the Companies Act'). Chapter V provides for the general aspects of the acquisition of majority interests – the direct or indirect purchase of 75 per cent of the voting rights – in companies, while Chapter VI regulates the conditions, procedural and transparency requirements of mergers and acquisitions as well as demergers and spin-offs. In addition, in Chapter X of the Companies Act some specific rules are laid down as far as the transformation of private and public limited companies is concerned.

Beyond the above sections of the Companies Act some more specific rules are provided by the Act CXL of 2007 on Cross-Border Mergers of Limited Liability Companies ('the Cross-Border Merger Act'), which serve to implement Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005. The specific regulations include provisions pertaining to the terms of prospective cross-border mergers, the reporting obligations of management and auditors, the registration of companies established as a result of cross-border mergers and also rules on employee participation.

As regards publicly traded limited companies, Chapter III of the Act CXX of 2001 on the Capital Market ('the Capital Market Act') contains specific provisions related to the acquisition of majority interest in public limited companies. Important provisions include compulsory reporting of any controlling stake acquired or relinquished in publicly traded companies, IPOs and other public share offerings, minimum offer prices, and subsequent offers by other companies. The Capital Market Act also provides for the permitted forms of target defence, permitted 'poison pill' techniques and rights of pre-emption. Furthermore, annexes to the Capital Market Act include guidelines and descriptions on the required elements of tender offers, such as the data required for the financial report, the future operations plan of the bidding company, and the required elements of the advisory opinion to be provided by the target company's management in response to a tender offer.

Tender offers are overseen and authorised by the Hungarian Financial Supervisory Authority ('PSZÁF'), the general supervising authority of financial institutions and markets. The structure, procedures and scope of authority of PSZÁF are detailed in the Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority.

In terms of M&A special legislation applies as far as credit institutions, banks, investment companies, insurance companies and private equity funds are concerned. Such specific laws provide further rules on the authorisation of mergers and demergers and on the conditions of gaining majority control in such types of companies.

Competition law aspects of M&A – especially approval and authorisation rules – are set out in the Act LVII of 1996 on the Prohibition of Unfair Trading Practices and Unfair Competition ('the Competition Act'), which is supplemented by the basic rules and procedures prescribed and issued by the Hungarian Competition Authority ('GVH').

Contracts in general – including merger agreements as well as share purchase and transfer agreements – are governed by Act IV of 1959 on the Hungarian Civil Code and the relevant case law. Conflict of laws rules may also have relevance; such provisions are governed by Statutory Rule No. 13 of 1979 on the Conflict of Laws.

Hungarian law requires most documents and information relating to companies to be registered with the courts of registration, with some of this information needing to be made available to the public. The above oversight activities and the procedures of these courts, along with regulations regarding company names and company dissolutions, are set forth in the Act V of 2006 on Public Company Information, Company Registration and Dissolution Proceedings.

Considering Hungary's membership in the European Union both competition law and financial supervision is subject to interaction with the authorities of other Member States of the EU and with the European Commission while the relevant EU laws having direct effect must be applied by the Hungarian authorities and courts.

It is also relevant from the aspect of M&A that Hungary is a signatory to a large number of bilateral investment treaties ('BITs') and therefore foreign investors are protected in Hungary also on the level of international law.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

In the past year, there have been no relevant developments in corporate and takeover law that would have any direct impact on takeovers or M&A activity and no such proposals were made by the government. Current Hungarian legislation has two basic aims: restructuring of the basic state structures and recovery from the financial crisis. The Parliament adopted the new Constitution of Hungary, which will come into effect on 1 January 2012. Other changes in the legislative regime that will have an impact on mergers and acquisitions fall within the scope of tax law. These reforms are dealt with in Section VIII, *infra*.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As explained in the introductory section, foreign investors' willingness to undertake risk has declined remarkably in the last years.

In 2008, approximately 75 per cent of transactions were concluded with foreign involvement (Austria, the United Kingdom and Germany being key players) and due to this percentage Hungary qualified as the second most popular target for foreign direct investment in central and eastern Europe.

However, since 2008 there has been a significant relapse in the foreign investors' acquisition activity. This year, the highest value deal so far was the completion of the acquisition of BorsodChem by WanHua of China for 300 million forints. In addition, the Hungarian State reacquired 21.2 per cent of the shares of oil and gas giant MOL from Surgutneftegas. Beyond these there were no relevant transactions with foreign involvement in the first quarter of 2011. Further significant transactions were made in the telecommunications and real property sector, please see Section V.

In 2010, there were four significant transactions where a Hungarian company acquired a foreign company. Almost 80 per cent of the chemical- and medicine M&A (which was the most popular sector in 2010) was composed of three transactions (acquisition of PregLem Holding SA, Grünenthal GmbH and the Protek Group) concluded by Richter Gedeon Nyrt. In addition, Díjbeszedő Zrt acquired 80 per cent of the shares of the Romanian GPV Mail Services SRL.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

In 2010, telecommunications, IT, chemical- and medicine industry and banking were the key industries for M&A in Hungary.

In terms of the number of deals, among the 127 transactions implemented in 2010, most deals – 20, in contrast to 14 in 2009 – were concluded in the telecommunications and IT segment. In the financial, business services and media sector, the number of successful transactions reached almost the same level with 13 mergers and acquisitions. The third-best segments were energy, food, chemical- and medicine and trade all with eight transactions.

As far as the volume of transactions is concerned, the most popular area of activity was chemical- and medicine, as the sector, taking into account its 26.5 per cent proportion of the aggregate value of transactions in 2010. In 2010, the highest value deal was the acquisition of 100 per cent of the shares of Invitel International Hungary Kft by Turk Telekomunikasyon SA from Invitel Holdings A/S. The total cash consideration for the transaction was approximately €197 million.

Further high-value transaction of 2010 involving foreign player was the acquisition of 50 per cent of the shares of the Allee Shopping Centre in Budapest by Allianz Real Estate of Germany for €100 million.

The second most important sector – similarly to 2009 – was the segment of financial services, however, the aggregate volume of transactions was 75 billion forints less than the year before. As the key transaction Trigránit Zrt acquired 100 per cent of the shares of Milton Bank Zrt from financial holding group Wallis. After the acquisition, the bank has operated under the name of 'Gránit Bank' as a commercial bank focusing on the SME sector.

In the industry sector, one of the highest-value deals in 2010 was the acquisition of 50 per cent of the shares of the Ukrainian ISD Group, which owns the largest steelworks (ISD Dunaferr) in Hungary, by the Russian Vnyesekonombank.

The biggest decrease regarding the value of transactions was in the energy sector, where the aggregate value fell from 660 billion to 65 billion forints, due to lack of mega transactions that were typical in this sector before.

In 2011, the highest value deal so far was concluded between the Hungarian state and the Russian Surgutneftegas on the 'reacquisition' of 21.2 per cent of the shares of the Hungarian oil and gas giant MOL. According to public information, the purchase price is €1.88 billion. The transaction shall be completed by the latest of 31 August 2011 by a majority state-owned company or institution, assigned in the future.

Most of the transactions in the first quarter of 2011 were concluded in the financial sector (six deals). After the modest acquisition activity of 2009 and 2010 this sector seems to be recovering. In addition, five deals were concluded in the media segment, which is traditionally active in the Hungarian M&A market. According to market analysts, the only dynamically developing sector of the Hungarian M&A market is the online media sector. As the most significant transaction in the transport and logistics sector, the biggest privately-owned Hungarian logistics company, Waberer Holding Zrt. acquired 34 per cent of the shares of the Pinebridge investment fund. Then these shares and a part of the shares of Waberer Holding Zrt was acquired by Mid Europa Partner private equity fund. Another significant private equity related transaction was the acquisition of Provimi Hungary Zrt (Prvimi Pet Food, an international pet food producer) by Advent International Co, a US private equity fund.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

On the financing side the global financial crisis resulted in significantly conservative credit policies. In past years banks have proven to be reluctant in providing acquisition financing for the types of deals that are occurring in Hungary. In addition, even if financing of a deal is approved by a credit institution the deal-making is taking longer now due to documentation requirements; banks are updating their existing standard documentation to the ones issued by the Loan Market Association more often and they are much more cautious about the legal provisions pertaining to them.

The approach of banks to financing shows differences in certain sectors; market data from the last years indicate that in certain industries banks are more willing to provide finance.

Nevertheless, while bank financing seems to recur gradually within the system, credit institutions are still demanding more equity and securities and this becomes even more severe when other sectors are taken into consideration. For example, in the absence of own funds companies operating in the real estate sector find it very complicated to secure any kind of M&A financing.

As far as private equity is concerned, its impact was significantly lowered in the last two years; the volume of such transactions fell by around 71 per cent. This type of financing, however, did not disappear: it seems that the conservative approach of banks tends to revalue the significance of private equity in terms of M&A financing. In the last year two trends are remarkable: on one hand, private equity tends to use its resources for refinancing companies in trouble; on the other hand, as far as the deals are concerned, smaller transactions became dominant. According to market analysts the relevance of private equity will definitely grow in the coming years due to their approach to risk as compared to credit institutions, as private equity is looking to conduct transactions in areas that credit institutions do not want to deal with, even if the industry is relatively fragmented. In addition, the introduction of the EU Jeremie Programme also increases the significance of private equity funds, although Jeremie Funds have role only as far as smaller (€0.5-1.5 million) transactions are concerned.

VII EMPLOYMENT LAW

As far as M&A is concerned employment law aspects are governed by two acts: the Cross-Border Merger Act and the Labour Code. The applicable provisions of these acts were not subject to any amendments in the last year.

The Cross-Border Merger Act governs the safeguarding of employees' co-decision and co-determination rights in the event of cross-border mergers of limited liability companies. Under the Act, as regards the participation rights of employees, it is the provisions of the Member State in which the seat of the post-merger company is located that apply. However, if any company participating in the merger has employed more than 500 people on average in the six months preceding the disclosure of the draft of the merger contract, and at this company an employee co-decision scheme was already in place prior to the merger, or if at any of the companies involved in the merger a higher proportion of employees is entitled to participate than is prescribed by the Companies Act, then the rules governing employee participation in the merger are determined in accordance with the provisions of the underlying EU Directive.

Furthermore employment law, or more precisely, Sections 85/A and 85/B of the Act XXII of 1992 of the Labour Code ('the Labour Code') – which implemented in Hungary the provisions of Council Directive 2001/23/EC on the Approximation of the Laws of Member States relating to the Safeguarding of Employee Rights in the event of Transfers of Undertakings, Businesses or Parts of Undertakings or Businesses – regulate all instances of 'employment assignment', defined as all cases where 'a separate and organised group of the employer's tangible or intangible assets (such as a commercial unit, manufacturer, business, workplace or parts of these) is transferred to a person or entity under the jurisdiction of this law, for the purpose of continued or renewed operation'. Section 70 of the Companies Act also assigns collective contracts concluded with trade unions to any and all legal successors of the original signatory company.

In the event of a transfer, all rights and obligations stemming from employment contracts under the previous employer are assigned by force of law to the transferee employer, regardless of origin. To add to the employers' responsibility, the transferor and the transferee have joint and several responsibility with respect to all employee claims presented within one year of the transfer if they concern issues pre-dating the transfer. In addition, the transferor employer acts as a guarantor for payments made by the transferee to terminated employees for a period of one year from the transaction, provided that the transferor and transferee share some link in terms of common ownership. Naturally, responsibility of this kind requires the transferor to share carefully and diligently all relevant information with the transferee, which the law stipulates as a general condition.

The bidder and the target companies must also cooperate in informing the trade union and the workers' council – or, in the absence of these, the committee formed from the representatives of the employees – of the reasons, details and foreseeable consequences of the transfer, at least 15 days before the transfer occurs. If the transferor or the transferee employer violates the rights of the workers' council or the trade union, the workers' council or the trade union may seek remedy through the courts.

VIII TAX LAW

In terms of mergers and acquisitions, two aspects of the Hungarian taxation system must be emphasised. Any profit realised on mergers and acquisitions is subject to personal income tax in the case of private individuals, and corporate tax in the case of companies. As of 1 July 2010 the corporate tax rate was cut from 19 per cent to 10 per cent in respect of the first 500 million forints part of the taxable basis with transitory rules applicable to the determination of the 2010 tax liability due to the mid-year change. The lower 10 per cent tax rate will be applicable to the entire tax base from 2013. With the 10 per cent corporate tax rate Hungary has one of the lowest corporate income tax rates in the EU.

In addition, mergers and demergers have corporate tax consequences in terms of both the predecessor and the successor company, and also as far as corporate tax preferences and the calculation of the tax base is concerned. The most important tax preference applies to preferential transformations. If the conditions of preferential transformation provided by Act LXXXI of 1996 on Corporate Taxation are met then the predecessor (in the case of mergers) the successor (in the case of demergers) is not obliged to modify its pre-taxation income and therefore, generally speaking, preferential transformations qualify as corporate tax-free. Furthermore, tax preferences are supported by one of the world's most favourable tax treaty networks, as Hungary is a signatory to a large number of double taxation treaties.

On the other hand, important changes were implemented to Act XC of 2010 on the Introduction of Special Tax and Banker's Contribution Intended to Improve the Balance of Public Finances ('the Bank Tax Act') as of 27 September 2010. According to the modification, a special tax shall be paid by financial institutions (commonly known as the 'bank tax'). The base and rate of the bank tax depends on the organisational form of the financial institution, in other words, there are different parameters for credit institutions, financial enterprises, insurance companies, investment firms, exchange market operators, commodity dealers, venture capital fund management companies and investment fund management companies. The bank tax as a special tax shall be paid by the financial institutions in 2010, 2011 and 2012. Pursuant to Section 6 (7) of the Bank Tax Act, financial institutions shall be liable to pay special tax in 2011 altogether in the amount of 200 billion forints.

In addition, special tax obligation was introduced by Act XCIV of 2010 on the Introduction of Special Tax on Certain Sectors as of 4 December 2010 on electronic communication service providers and power-supply enterprises. In case of electronic communication service providers the tax rate is 4.5 per cent of the net income exceeding 500 million forints but not exceeding 5 billion forints, plus 6.5 per cent of the net income exceeding 5 billion forints. In case of power-supply enterprises the tax rate is 0.3 per cent of the net income not exceeding 5 billion forints, plus 1.05 per cent of the net income exceeding 5 billion forints.

IX COMPETITION LAW

Competition law aspects of M&A are governed by Chapter IV of the Competition Act (Concentration Control). The threshold of materiality above where permission is necessary from the Hungarian Competition Authority ('GVH'), is 15 billion Hungarian forints net income for the entire corporate group, as defined in Regulation 139/2004/EC on Mergers, and more than 500 million forints net income achieved by at least two of the companies involved. In case of insurance companies the gross insurance fees, in case of banks and credit institutions specific income items are to be taken into account instead of net income.

The temporary exemption period with respect to the competition procedure for insurance companies, financial holdings, credit institutions, banks, private equity funds, mixed holdings and the like, described in Article 3(5)(a) of the EC Regulation on Mergers, is specified in Hungarian law as one year, when the sole purpose of the acquisition is to resell the company. The one-year time limit may be extended by GVH if the acquirer proves that resale of its company was not possible within the deadline.

The request for GVH's permission to go forward with a merger must be filed within 30 days of either the public tender, the conclusion of the merger contract, or the acquisition of the rights of control, whichever is earliest. In its decision, the authority may order a wide range of measures, including tying the validity of the merger to certain pre- or post-merger conditions, ordering the sale of certain assets, companies or businesses, and weighing a wide range of circumstances before making its decision. These circumstances may include market structures, prices, impacts or risks, as well as the companies' positions, strategies, outlook, means of action and opportunities for growth or future activity.

The latest amendment of the Competition Act came into effect in January, 2011; beyond certain procedural modifications and clarifications, however, no significant amendments were made thereto.

X OUTLOOK

In 2011, according to market analysts, the most attractive sector will be the energy and financial sectors, car industry, technology and online investments. The Jeremie Programme should also give further boost for smaller investments, nevertheless this will not have a significant effect on the aggregate value of transactions as the maximum amount to be spent is €1.5 million per deal.

The Hungarian M&A market accelerated considerably in the last quarter of 2010 compared to 2009. However, it must be noted that the market optimism is fragile and the recent trends show significant fallback compared to the expectations. In the first quarter of 2011 the number of transactions concluded fell to the level of the first three quarters of 2010. The aggregate value of the transactions concluded in the first quarter of 2011 is distressing taking into account that 300 billion forints of the aggregate 380 billion transaction value resulted from the *BorsodChem/WanHua* deal. With a value of 84 billion forints in the first quarter of 2011 it is the weakest of the last 12 quarters. That said, despite the above transactions, significant recovery is unlikely in the Hungarian M&A market in 2011.

Appendix 1

ABOUT THE AUTHORS

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Péter Berethalmi is the managing partner of Nagy és Trócsányi. In addition to his position as managing partner, Mr Berethalmi is a partner in the firm dealing with mergers and acquisitions, property transactions and project finance matters. His clients include foreign multinational corporations and financial institutions. Mr Berethalmi joined the firm in 1996; he has been a partner since 2001 and became managing partner in 2005. He speaks Hungarian and English.

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