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→ IPO – Going public on the stock exchange

Obtaining financing via the capital market by means of the so-called IPO ("Initial Public Offering") has become very popular among investors and companies in recent years. In Germany, the focus is mainly on Frankfurt. The reasons for going public are manifold and include, in particular, raising additional equity capital for the future, approaching a national or international group of investors, achieving high free float, and increasing company awareness.

Many steps need to be taken before the first placement of the shares on the stock exchange. In the following, we discuss the challenges awaiting first-time issuers and outline the essential steps of the flotation process.

Requirements and obligations

Implementing the right structure involving a listed (German) stock corporation or a European Company (SE) and meeting all other IPO readiness requirements usually takes at least 12 months. The company must first meet various legal requirements, board members and key employees must undergo appropriate training. Also the right stock exchange must be found. The admission requirements for an IPO depend on the so-called stock exchange segment – i.e. the sub-market of the stock exchange – in which trading is to take place.

Therefore, differences between the segments should be considered. While in the open market (OTC) the general terms and conditions of the respective stock exchange as well as the regulation for inside information and public disclosure of inside information must be taken into account, in the so-called regulated market all capital market regulations apply in full, in particular the Stock Exchange Act, the Securities Trading Act, the Securities Acquisition and Takeover Act as well as the German Corporate Governance Code as the so-called "soft law".

In the regulated market, there are two segments, the General Standard and the Prime Standard. In the General Standard segment, the statutory minimum requirements apply, i.e. issuers must publish an interim report, make ad hoc announcements and apply the International Financial Reporting Standards. In addition to the requirements of the General Standard, the so-called Prime Standard contains further follow-up requirements that are of particular relevance for international investors, because strict international transparency requirements apply in this case. These include publishing quarterly reports and ad hoc announcements in English, keeping a corporate calendar and holding at least one analysts' conference per year.

When deciding between the OTC market and the regulated market, it is essential to bear in mind that institutional investors such as insurance companies, pension funds, etc. only want to or are only allowed to invest in issuers listed on the regulated market. Both in the OTC market and in the regulated market, the regulations of the Market Abuse Regulation (MAR) must be followed with regard to insider dealing, public disclosure of inside information, the so-called director's dealings and market manipulation. On closer look, it should therefore be considered whether it would not be better to seek a direct path to the regulated market, as the reliefs offered by the law for the OTC market issuers are still scant.

The IPO Process

Companies looking to debut on the stock exchange will generally need the support of their underwriting bank or a banking syndicate. It must be checked in which kind of placement of the issuer's shares and in which stock exchange segment the bank has expertise. Depending on the size, scope and placement of the new shares (national/international), the ideal bank should be selected in a so-called "beauty contest". What is important for the underwriting banks, among other things, is the pursued trading volume and the pursued further growth to be achieved by means of possible future corporate actions. The following important steps should be taken in preparation for the IPO:

- Preparation of a comprehensive securities prospectus
- Preparation of other contractual documentation

- Approval of the securities prospectus by the Federal Financial Supervisory Authority (BaFin)
- Official announcement of the intention to float
- Pre-marketing with institutional investors in Germany/abroad.

From the moment the prospectus is approved, the so-called placement phase ("going public") starts, which includes the following steps:

- Marketing campaign
- Marketing including a "roadshow" for institutional investors in Germany/abroad
- Often the so-called book-building process
- Determination of the issue price
- Approval by the admission board of the stock exchange
- Underwriting agreement
- First listing on the quotation board.

Finally, during the listing phase ("being public"), if needed, the underwriting banks may stabilize the share price, contact with investors must be maintained ("investor relations") and follow-up requirements must be fulfilled. These requirements include ensuring compliance with the regulations arising from MAR, IFRS reporting (depending on the segment), and specific regulations under stock corporation law, such as presenting a system for remunerating the management board, disclosing related party transactions, and ensuring compliance with the reporting thresholds under the Securities Trading Act.

Conclusion

The capital market offers many opportunities for companies, especially to raise additional equity to finance further growth. It should always be borne in mind that an IPO involves special challenges that require strategic far-sighted planning. It is advisable to check already at an early stage which goals the IPO should fulfil, which stock exchange is the right one and which preparatory measures should be taken.

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→ IPO Readiness – More than just IFRS compliance

Whether a fledgling start-up company or a medium-sized global market leader: German companies are increasingly facing global competition. Going public through an Initial Public Offering (IPO) can be an attractive way to finance growth or a possible EXIT strategy – even or especially in the current market environment. However, a successful IPO requires some changes in the company's structures and processes in order to meet the necessary admission and follow-up requirements. Ensuring IPO readiness early on and in a targeted manner is therefore an important factor for a successful future on the capital market.

IFRS reporting as a basic requirement

The basic requirement for the admission and listing on the regulated market is that the issuer must follow the International Financial Reporting Standards (IFRS). For companies that do not yet prepare their accounts according to IFRS, the conversion to IFRS is therefore usually one of the first items on the action plan for becoming ready for the capital market.

Converting to IFRS involves different professional requirements as regard the persons involved and requires the development of new know-how. However, the conversion does not only affect accounting, but requires a closely interlinked collaboration between many corporate divisions in order to determine which information is necessary for accounting and reporting purposes. Processes and IT systems will also have to be adapted to the new challenges. It is therefore advisable to convert to IFRS allowing appropriate lead time before the planned IPO. In this way, the company has enough time to set up new accounting processes and meet the stricter reporting requirements under IFRS before additional transparency requirements related to being listed on the stock exchange come in. Then, once the company *is public* this is where it really starts.

Digitising the financial processes

Speed is an essential building block for successful communications with capital market players. Investors and analysts expect to receive reliable data about the company swiftly. And that at the highest level of quality. Once the company becomes listed on the stock exchange, the range of financial reports expands to include mandatory reports (e.g. quarterly reports, half-yearly financial reports, ad hoc announcements, sustainability reports) and voluntary reports (e.g. press releases, analysts' events and conference calls). The scope of necessary reporting increases also within the company itself. For the governance of the company, management needs transparent insight into the financial and non-financial figures at all times.

The digitisation and automation of financial processes can help to achieve the desired effects and thus save time and resources while increasing quality. The use of modern ERP systems, financial performance management software and disclosure management systems makes it possible to create a financial reporting process that will be as best digitised and with as few interfaces as possible. Standardisation and clear processes reduce manual, time-consuming workload. This reduces the time required for closing accounts and enables using the available resources in a targeted way. In terms of an IPO, the focus should therefore always be on improving the existing structures and processes.

Transformation of Corporate Governance structures

The pressure on *good governance* is growing massively and is increasingly becoming the focus of investors and analysts. The debut on the capital market comes with an increasing set of requirements for governance, risk and compliance management structures (GRC structures). National initiatives such as the Act to Strengthen Financial Market Integrity (Finanzmarktintegritätsstarkungsgesetz, FISG) as a reaction to the Wirecard & Co case, regulatory requirements of the Federal Financial Supervisory Authority BaFin or those of the company’s target stock exchange are the focus here.

Especially for owner-managed medium-sized companies, it is important to conduct a fit-gap analysis early on so as to identify the necessary steps for establishing a GRC structure

that will make a company ready for debuting on the stock exchange and to set the right course.

Essential components of good governance structures include risk and compliance management as well as the internal control system (ICS). The use of appropriate instruments improves the management and monitoring structures in the company and aims to ensure its sustainable growth.

GRC structures should be tailored to the size and needs of the company. In this process, one should take a broader perspective and plan the company's future – holistically and with the use of digital solutions.

Conclusion

Preparing for an IPO means much more than just converting to IFRS. Structures and processes must be adapted to the new requirements of the capital market. In addition to the classic financial reporting processes, this also concerns non-financial reporting as well as governance, risk and compliance management structures. The FISG is just around the corner. The topic of IPO readiness should therefore be put on the agenda of decision-makers early on if going public is planned in the future. Because readiness for going public is a matter for the boss.

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→ Selected tax aspects of IPO

In an IPO ("Initial Public Offering"), not only company and financial law aspects but also tax law issues are relevant. These arise not only during the process of implementing the company's legal structure for going public but also during the IPO process itself. In this article, we therefore discuss selected tax aspects that are important for German companies looking to debut on the stock exchange.

Changing the legal form of a company preparing for an IPO

Since only stock corporations can go public, a company preparing for an IPO but not having a corresponding legal form often first has to transform into a stock corporation, a partnership limited by shares or a European Company (SE). Such changes of the legal form are possible under the German Transformation Act (Umwandlungsgesetz).

If the company preparing for an IPO is a limited liability company (GmbH), the transformation into a stock corporation (Aktiengesellschaft) is income tax neutral, as the company retains its identity and continues to be taxed as a corporation. Therefore, the change of the legal form will not trigger any property transfer tax, either.

The situation is different if the company looking to go public has the legal form of a partnership, such as GmbH & Co. KG, for example. In this case, an income tax-neutral change of the legal form is only possible if the company is appropriately structured in accordance with the German Transformation Tax Act (Umwandlungssteuergesetz). It should be noted that special business assets may also have to be transferred to the company looking to go public and that there is a lock-up period for the shares in that company. In terms of property transfer tax, no transfer of property takes place, but existing holding periods may trigger real estate transfer tax (RETT) in individual cases.

For companies looking to trade their stocks on global stock exchanges, the SE may be a suitable option, whereas it is necessary to carefully plan the structure from the aspects of international tax law.

(Tax) due diligence and IPO Readiness

If the company seeking to go public is required to prepare a prospectus in accordance with the German Securities Prospectus Act (Wertpapierprospektgesetz), due diligence is necessary. In this context, tax due diligence must also be carried out. The company must therefore be prepared to provide tax documents and information as well as identify tax risks. Such risks often arise, for example, from

- holding periods arising from restructuring measures that were not observed;
- incorrect assessment of bulk transactions for VAT purposes;
- accidentally triggered real estate transfer tax issues
- non-arm's length inter-company relationships;
- unrecognised foreign permanent establishments;
- internal contracts that do not comply with tax requirements (e.g. profit and loss transfer agreements).

If material tax risks are identified during a tax due diligence, these may have to be included in the prospectus. The identification and settlement of "past tax burdens" should therefore be dealt with even before an IPO. In addition to the structuring of the company looking to go public, this is an essential part of an IPO readiness project.

Does IPO lead to forfeiture of interest and loss carry-forwards?

If more than 50 per cent of shares in a company are transferred to an acquirer or a group of acquirers, tax losses and interest carry-forwards may be forfeited. At least the interim acquisition of shares by an underwriting bank is treated by tax authorities as a harmless transfer. The acquisition of shares by new shareholders is usually not critical in the end, because it leads only to the creation of minority shareholdings or sufficient hidden reserves within the company can be evidenced. Nevertheless, tax monitoring is important.

Costs of Going Public

Going public involves considerable costs, in particular costs of issuing shares and fees for advisors involved. Costs of increasing capital can be deducted as tax-deductible expenses according to case law. Thus, the costs of going public in the narrower sense are generally deductible at the level of the company seeking to go public. Costs are not tax-deductible only if they are induced by the shareholders and can lead to a hidden distribution of profits. Costs incurred by the company for going public may entitle the company to deduct input tax. If the raised capital serves to generally strengthen the company's operations, input tax can be deducted according to the allocation key otherwise applied for general costs.

Conclusion

A planned IPO involves many tax aspects that should not be neglected. Already in the early stages of planning, it is reasonable to investigate the tax feasibility of the desired IPO structure chosen under company law in order to avoid surprises.

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→ M&A Vocabulary – Understanding Experts

„Discount for lack of control, control premium“

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.

A "control premium" is defined as an amount or percentage, by which the controlling interest, exceeds the non-controlling interest in an entity to reflect management power.

Conversely, an amount or percentage deducted from a proportionate share of 100 per cent of a company's shareholding, to reflect the lack of some or all control power is defined as a "discount for lack of control".

Large blocks of shares are often transferred at different prices than individual shares during day-to-day trading on the stock exchange. These relative price differences can be significant if the change in ownership of the shares leads to a change in control, such as when more than 50 per cent of the voting rights are acquired. In this case, a potential buyer may be willing to pay a higher price for the company shares than the price that would arise from a mathematical calculation if the equity value of the company as a whole was broken up into the number of shares involved in the transaction. The difference between the market price of a share quoted on the stock exchange and the price of the shares through which control is acquired can – at least in part – be attributed to such a control premium, paid for the acquisition of the power to manage the company’s operations.

For example, a company has two shareholders holding 80 per cent and 20 per cent of the shares, respectively. If the equity value of the company is 10 million euros, a reasonable buyer will usually not be willing to pay a price of 2 million euros for 20 per cent of the shares. The discount from the 2 million euros is – in part – the discount for lack of control.

Control Premium and Discount for Lack of Control in Acquisitions

For synergistic effects or rational reasons, add-on acquisitions or takeover bids may lead to premiums on the equity value or stand-alone value of the shares to be acquired. For the prospective buyer, it may be worth assessing before a transaction whether a premium actually constitutes a control premium or rather:

- represents a premium for synergy effects;
- covers aspects relating to tradability of shares;
- ensures access to information relevant to the valuation; or
- takes into account the quality of this information
  or perhaps is simply an overpayment by the acquirer

in order to induce as many shareholders as possible to accept the bid.

The value at which the main shareholder can obtain its right of first refusal can be clarified in articles of association or shareholders' agreements of non-listed companies. A specific definition of the transaction price can limit or clarify the arbitrariness of the discount for lack of control.

Studies show that the level of the control premium depends on factors such as industry sector, time, type and size of the transaction, while the size of the company does not seem to be an influencing factor. In addition, it has been observed that the control premium in market-based systems where companies raise financing to a greater extent via the capital market, is significantly higher than in bank-based systems.

The level of the control premium may vary depending on which and how many aspects of control are included in the premium, as well as the level of worth, that the acquirer, via his opportunities to influence, can convert to the business as appreciation in value.

CONCLUSION

In the case of transactions involving blocks of shares, which result in a transfer of corporate control, the encirclement of the control premium in terms of value, can make up a considerable proportion of the transaction price.

The economic understanding of the distinction between the control premium and possible other premiums or discounts enhances the quality of the bid in connection with the calculation of the value-added that the share acquisition can create for the acquirer.

Similarly, the discount for lack of control is an important aspect for minority shareholders in terms of understanding how the value of shares is derived in light of definitions included in articles of associations or sharehol-ders' agreements. Minority shareholders of a company should clearly define the valuation method in articles of associations or a sharehol-ders' agreement in order to understand the mino-rity discount concept that can be applied when disposing of their shares. This is because the definition of contractual provisions on the disposal of shares can significantly influence the process of determining the value.

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