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AMF

## AMF Position – recommendation No. 2011-11
## Transfers of assets and mergers

**References: Article 212-34 of the AMF General Regulation**

This Position is in line with the terms of the 1977 Recommendation on information to shareholders and on consideration for transfers in merger, partial merger or demerger transactions. It is also in line with the policy that the AMF applies to contributions in kind and partial mergers.

This Position-Recommendation deals with the principle of a multiple-criteria approach in merger and transfer of assets transactions and also with the principle of extending the engagement of the *commissaire aux apports* (valuing auditor for asset transfers) to include examination of the share exchange ratio in transfer-of-assets transactions.

### 1. Multiple-criteria approach in merger and transfer of assets transactions

The 1977 Recommendation laid down the principle of a multiple-criteria approach, which has long since been extended to other types of transactions, along with a number of rules to apply the criteria so that auditors (*commissaire aux apports* or *commissaire à la fusion)* can substantiate and justify their opinions on the consideration transferred. The Recommendation stated that a clear distinction should be made between two notions: the value of the assets received and the measurement of the consideration transferred.

In accordance with company law, auditors in such transactions provide an unqualified opinion once they are sure that the relative values attributed to the shares of the companies participating in the transaction are relevant and that the share exchange ratio is fair. Auditors should also ensure that the value of the assets transferred is not overstated compared to the expected amount of the increase in equity, plus any potential premium.

In practice, in a merger or a transfer of assets transaction, issuers are required to disclose useful information to shareholders on consideration for and/or value of the assets transferred for shareholders to decide whether to approve the transaction by voting at a general meeting. This information is presented in a document filed with the AMF on a timetable consistent with that of the general meeting.

Consequently, it is helpful to review some of the main disclosure principles relating to merger and transfer of assets transactions, concerning the information provided by issuers or auditors, specifically on the value of the assets transferred and on the share exchange ratio.

#### 1.1. Presentation of the value of the assets transferred

Issuers approximate the actual value of the assets transferred using various criteria and methods, among which:

- Market value, if, in a merger (or transfer of assets) transaction, the target company (or the company contributing the shares) issues shares that are traded on a regulated market;
- Profitability (capitalisation of normalised expected earnings, discounted expected cash flows, etc.);
- Asset value (adjusted net assets, etc.);
- Value comparisons (comparison with peer share prices or similar transactions).

The approach to valuing assets transferred should take into account the characteristics of the business, the market and the entity-specific profitability of the assets.

To this end, issuers should explain in the documents required by the AMF[1] how they determine the value of the assets transferred using a multiple-criteria approach.

To assess the relevance of this approach, auditors should analyse the context of the transaction to determine which valuation approaches seem appropriate based on this multiple-criteria analysis. Auditors are also responsible for any additional analyses that may be required.

As required by the technical opinion of France's national auditing board[2], auditors should consider all the data received from the issuer or external sources with a critical eye. Auditors should assess whether assumptions are reasonable, and whether the various values used are appropriate and relevant. Where necessary, auditors should investigate if the implementation of other valuation methods or criteria could have been appropriate and they should assess the impact of those other methods.

On this basis, auditors' reports should describe the multiple-criteria analysis and the judgement that led to choosing or rejecting a specific method.

After completing the analysis, auditors should provide an opinion on the value of the assets transferred compared to the aggregate actual value resulting from the approach chosen. If the assets are overstated, auditors should draw the conclusions in their opinions.

### 1.2. Presentation of the factors used to assess the share exchange ratio[3]

A prerequisite for assessing the consideration for transfers of assets is an understanding of the economic context of the transaction. The share exchange ratio[4] results from negotiations between the offeror and the target company and it should result in a balanced treatment of the interests involved. Consequently, an unfair share exchange ratio would harm the interests of the shareholders of either the offeror or the target company.

This problem calls for a greater effort to achieve the necessary transparency regarding the approach chosen and the methods used. In practice, issuers have to present the relative values with reference to various criteria and different methods, such as:

- Discounting of expected cash flows;
- Comparisons with other share prices;
- The share price criterion;
- Asset value (adjusted net assets, etc.);
- Comparison with similar transactions.

The share exchange ratio depends solely on the choices of the companies involved in the transaction. Nevertheless, if these companies reject valuation methods, it would be helpful to explain why.

Therefore, issuers must explain in the documents required by the AMF[5] how they determined the share exchange ratio and the relative values using a multiple-criteria approach.

[1] Document E for the purpose of Article 212-34 of the AMF General Regulation and Instruction 2005-11 of 13 December 2005
[2] CNCC Technical Opinion on the appraisal of partial mergers (CNCC- 20 January 2011)
[3] For transactions involving payments in shares or other securities providing access to equity
[4] The share exchange ratio is the number of shares that the target company has to issue in exchange for the partial merger.
[5] Document E for the purpose of Article 212-34 of the AMF General Regulation and Instruction 2005-11 of 13 December 2005

In order to assess the appropriateness of the approach chosen, as required by the French auditing board's technical opinion[6], the auditor (*commissaire à la fusion* or *commissaire aux apports*)[7] must consider all the data provided by the issuer with a critical eye. They must ensure that the relative values presented were arrived at through proper application or implementation of the criteria and methods chosen and ensure that the calculations were made uniformly for each entity. The auditors must also ensure that the only appropriate methods were used and that only inappropriate methods were rejected.

In order to substantiate the relative values attributed to shares in the planned transaction, the auditor[6] may also have to assess the impact that changes in the assumptions and parameters used would have. In this way, the auditor determines whether such a "sensitivity" analysis calls the relevance of the range of relative values set out in the draft merger agreement into question.

The auditor's report[6] describes the multiple-criteria analysis and the approach that led to choosing or rejecting a given method.

After completing the analysis, the auditor[6] must express an opinion about the fairness of the share exchange ratio. If there is a disagreement, the auditor will make the appropriate statement in the findings.

**Position**

In a merger or transfer of assets transaction, issuers are required to provide their shareholders, who have to vote to approve such transactions, with all of the information that is helpful for a sound understanding of a transaction and its impact. To this end, the AMF requires issuers to use a multiple-criteria approach to determine the values used.

The various commonly accepted methods must be described clearly in the documents required by the AMF and the rejection of certain methods must be explained.

The valuing auditor (*commissaire à la fusion* or *commissaire aux apports*) must examine all the data provided by the issuers with a critical eye. Their reports should be detailed both with respect to the appropriateness of the methods used and on their proper implementation so that shareholders can assess the compensation being offered to them in the transaction. The auditors must give an opinion regarding the fairness of the share exchange ratio.

The auditors' reports must comply with the technical opinions of the French auditing board regarding appraisals for merger and transfer of assets transactions.

[6] CNCC Technical Opinion on the appraisal of mergers (CNCC- 6 December 2010)
[7] This point applies to the *commissaire aux apports* if the assigned engagement has been extended to include a fairness opinion.

## 2. Extending the auditors’ engagement to include a fairness opinion regarding the share exchange ratio in transfers of assets

In asset transfers that are not subject to the rules on demergers, only a report from a *commissaire aux apports* is required. The purpose of the report is merely to determine the value of the transferred assets, not the fairness of the consideration for them.

The AMF always asks for the engagement of the *commissaire aux apports* to be extended to include an unqualified opinion regarding the share exchange ratio being offered. It should be possible to make this extension in the Commercial Court ordinance appointing the auditor.

This extension would ensure proper disclosure to shareholders, who have to agree to a dilution of their shareholdings when they vote to approve a transfer of assets. Therefore, the AMF has grounds to require that the companies under its purview should produce a report on the consideration for the assets transferred. In fact, any company can produce such a report under the terms of Article L. 236-22 of the Commercial Code.

The auditor assesses the share exchange ratio and expresses an opinion as to its fairness.

**Position**

In a transfer of assets transaction, the AMF always requires the engagement of the *commissaire aux apports* to be extended to include the consideration for the transferred assets in order to assess the fairness of the share exchange ratio. The auditor’s reports must comply with the technical opinions of the French auditing board regarding appraisals for merger and transfer of assets transactions.

Furthermore, before accepting the engagement, the auditor must assess the possibility of carrying it out in accordance with the general principles of the statutory auditors’ code of ethics. However, potential or existing conflicts of interest must also be taken into account once the engagement has been accepted. In practice, some commercial courts ask the auditors to file statements of independence.

Consequently, a letter from the auditor can be used to ensure that potential conflicts of interest are presented in the documents submitted to the AMF. Where appropriate, this letter could be the same as the statement provided to the commercial courts requiring such statements.

**Recommendation**

In merger and transfer of assets transactions, the AMF recommends that the valuing auditor (*commissaire à la fusion* or *commissaire aux apports*) for the transactions should analyse potential conflicts of interest as soon as the engagement is accepted and should submit a letter explaining their analysis to the AMF.