

Short version

# **Guidelines for the Preparation of Fairness Opinions**

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## Guidelines for the Preparation of Fairness Opinions

### 1. Goal of the guidelines

A Fairness Opinion is a statement by an expert third party about the financial adequacy of the purchase price or offer price in the case of a corporate transaction. A Fairness Opinion is prepared, among other instances, at the request of the governing bodies of the involved companies in connection with the purchase and sale of shares and the acquisition of listed companies in the context of public takeover and delisting offers.

The central function of a Fairness Opinion is to protect the engaging corporate governing bodies against risks of liability. The Fairness Opinion also serves as independent validation of the decision by the governing bodies with regard to the shareholders, analysts and, if applicable, the capital market. The guidelines presented here are supposed to specify the standard for evaluating financial fairness and the methods which are supposed to be applied for this evaluation. This appears appropriate in light of the large number and importance of corporate transactions and the lack of uniform application of principles about Fairness Opinions by different issuers and, thus, related questions raising doubts.

### 2. General legal requirements

The governing bodies of a corporation have the legal protection ("safe haven") of the business judgment rule in the case of corporate transactions such as is provided for e.g. in stock corporations law in § 93 para. 1 sentence 2 German Stock Corporations Act (*Aktiengesetz*, "AktG") when the governing bodies can reasonably believe on the basis of reasonable information that they are acting in the interests of the company. If the governing bodies of a corporation obtain a Fairness Opinion, this is a material argument for having acted on the basis of reasonable information. The existence of a Fairness Opinion alone, however, is not sufficient; the governing bodies must examine the Fairness Opinion in accordance with their duties with regard to its adequacy, and the governing bodies must make sure that they are basing their decisions on correct and complete information for the evaluation.

Two requirements must be satisfied to evaluate whether a transaction serves the interests of the company:

- The corporate bodies must formally implement the transaction in a process which corresponds to the requirements when acting like unrelated third parties (at arm's length). Obtaining a Fairness Opinion is a substantial indication for compliance with this requirement, especially if conflicts of interest exist.

- The consideration for the intended transaction must be adequate. This requires for both parties to the transaction the valuation of the transaction object based on going concern and the assessment of the entire financial benefits and disadvantages from the transaction (e.g. expected synergies or loss of synergies in existing group structures). If the transaction object is stock listed, the stock price and the offered premium on top of the stock price must be considered.

### 3. Requirements for the preparation of the Fairness Opinion

The clients and primary addressees of the Fairness Opinion are the governing bodies of the seller or the buyer. In order to avoid conflicts of interest, the general recommendation is to select an independent provider. If a provider is chosen who is otherwise involved in the transaction, potential conflicts of interest must be disclosed. If necessary, an additional, external Fairness Opinion must be requested in this situation. The providers of the Fairness Opinions must take organizational precautions in order to avoid conflicts of interest. The compensation for the preparation of the Fairness Opinion can be freely agreed, but it should not depend on either the conclusion of the transaction or the assessment made about the financial adequacy.

### 4. Requirements for the content of the Fairness Opinion

The Fairness Opinion consists of the Valuation Memorandum and the Opinion Letter. The **Valuation Memorandum** contains the comprehensive explanation about the fairness conclusion, the applied methods and the material valuation assumptions. The **Opinion Letter** contains a brief summary of the conclusion about the financial adequacy ("fair/unfair from a financial perspective"). The guidelines furthermore recommend disclosure of the summarized value ranges and the applied methods.

### 5. Economic criteria for the assessment

The financial adequacy of the consideration must be evaluated exclusively in accordance with financial criteria. The minimum requirement is that the relevant party is not placed economically in a worse position by the transaction than without the transaction. Furthermore, the determination of the entire financial benefits and disadvantages from the transaction and how they are allocated between the two parties to the transaction is important.

a) Evaluation from the buyer's perspective

- In the case of cash consideration, the purchase price can be allocated to the value of the transaction object operated by the seller as a going concern and the premium offered by the buyer. If the transaction object is stock listed, the stock price and any premium offered on top of that price must be included. The value of the transaction object when continued by the buyer incl. the value of all related financial benefits and disadvantages must be compared with this. The above-mentioned minimum requirement is that the value determined in this manner for the received consideration corresponds at least to the offered purchase price.
- If the **consideration is a participation in the buyer**, the evaluation of the consideration also includes the valuation of the buyer incl. the stock price. All financial consequences of the intended transaction must also be taken into account in this situation. The final assessment results from a comparison of the two following financial positions of the buyer:
  - o the value of the buyer's company on a going concern basis while not entering into the transaction.
  - o the value of the buyer's share in the company after contributing the subject of the transaction. This value includes the respective values of the contributed subject of the transaction and the buyer's business as a going concern as well as all positive and negative financial consequences of the transaction (synergies, costs for integration etc.).

In both cases, the determination of the entire financial benefits enables not only an evaluation of the financial benefits of the transaction for the buyer, but also the evaluation of the allocation of the financial benefits to both parties in the transaction.

b) Evaluation from the seller's perspective

- In the case of **cash consideration**, the evaluation can initially be made by comparing the value of the transaction object as a going concern continued by the previous owner (if applicable, taking into account the stock price) and the offered purchase price. The desirable assessment and evaluation of the entire financial net benefits and the participation by the seller in these benefits is frequently not possible. This can be substituted by an evaluation of the offered premiums on top of the value as a going concern or on the stock price.
- In the case of consideration in the form of a **direct or indirect participation in the buyer**, the evaluation again requires determining the value of the transaction object as a going concern continued as planned by the previous owner. This is compared with the value of the proportionate value in the joint company. The value of the entire company as a total of the two values of the buyer's business and the transaction object as well as the financial benefits which can be generated from continuing the business together must be determined. In this situation, the seller

participates in the financial effects from the transaction; therefore, the knowledge about these effects is necessary for evaluating financial adequacy.

The above-mentioned minimum requirement demands from the perspective of the seller that the value of the received consideration determined in this manner corresponds at most to the offered price.

## 6. Methods for valuation and determining financial adequacy

In order to evaluate the financial adequacy of the consideration or the transaction price, a company valuation must be carried out. The provider of the Fairness Opinion can use the methods for determining enterprise value which are recognized in business management. The application of multiple valuation methods is recommended, especially income oriented valuation methods such as Discounted Cash Flow methods, market-oriented valuation methods using trading and transaction multiples as well as analyses of market capitalization of the valuation object. The valuation methods are generally **equivalent**. Depending on the chosen input factors, different equity values result even within the different valuation methods. The provider of the Fairness Opinion must also take into account the resulting uncertainty about the value by presenting the result as **value ranges** and providing reasons for the final conclusion about the financial fairness.

### d) Evaluation of financial fairness

The provider of the Fairness Opinion performs an overall evaluation of the results of the valuation on the basis of the determined value ranges. It is generally not necessary for the ranges resulting from different valuation methods to be compressed into an additional, tighter range or even a specific value. It is sufficient for evaluating fairness that the provider of the Fairness Opinion weighs the ranges of value under different valuation methods and the general benefits and disadvantages of the individual methods as well as potential limitations and concludes in the specific case that the value of the consideration for the buyer or the seller is financially fair for the transaction which is being evaluated.

## 7. Disclosure

There are no rules in German law about disclosure of Fairness Opinions. If the opinion is written in connection with a statement pursuant to § 27 German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*, "WpÜG"), the principles recommend disclosure of the Opinion Letter with the statement.

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