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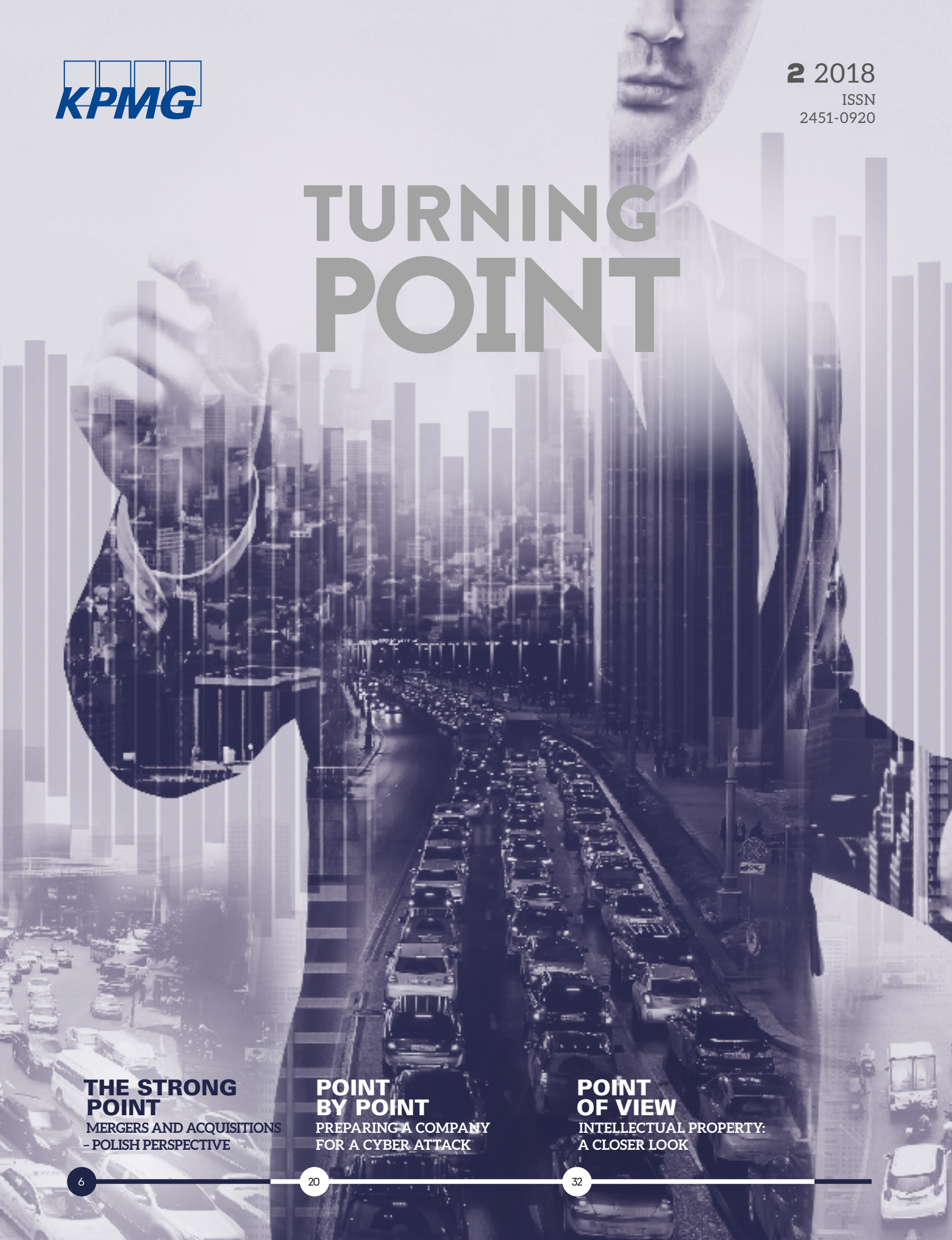
TURNING POINT



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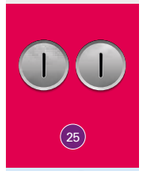

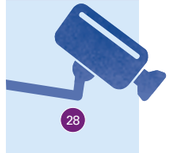

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>> GDP is growing at a much faster pace than in the "old EU", which attracts investors and is conducive to making decisions regarding mergers and acquisitions. Meanwhile, we do not expect interest rate hikes in the near future, so the cost of money will remain low.

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MERGERS AND ACQUISITIONS – POLISH PERSPECTIVE

Krzysztof Klamut in a conversation with the editors on the current situation and the overall outlook of the mergers and acquisitions market in Poland.

Turning Point TP >: What will the next few months on the mergers and acquisitions market in Poland bring?

KRZYSZTOF KLAMUT:
The last three years, both in the Central and Eastern Europe region and on the global market, have been very successful in terms of activity in the mergers and acquisitions sector. Suffice to say that after years of lower activity, its level measured in the number of transactions exceeded the level from 2007-2008, i.e. the period preceding the first wave of the financial crisis. Many experts predict that the period of economic prosperity is coming to an end, but hardly anyone expects the positive trend to be reversed this year. I therefore expect that the whole of 2018 will be successful. Polish GDP is growing at a much faster pace than in the "old EU", which attracts investors and is conducive to making decisions regarding mergers and acquisitions. Meanwhile, we do not expect interest rate hikes in the near future, so the cost of money will remain low. This is important because, despite the fact that corporations can boast of unprecedented cash reserves in their balance sheets, an essential number of transaction is made up of leveraged transactions, where the use of

The Polish market is still very fragmented. Large transactions in course of which the purchase of a given company would give the buyer a powerful position on the market are a rarity. Therefore, Polish companies and Poland-based PE funds carry out the majority of acquisitions of our local entities.

credit is an important part of investment efficiency. This applies in particular to investments carried out by financial investors. It is worth noting that recently many Private Equity (PE) funds have raised capital for investments and are currently looking for interesting assets, hence one should hope that the availability of cheap debt financing will give impetus to this particular market. While more transactions are usually concluded in the second half of the year, from the point of view of a consultant working on the entire M & A transaction cycle (which usually lasts approx. 9 months) we see that the number of conversations and inquiries regarding transactions in the first quarter of 2018 was very high.

TP › Does the question of succession in Poland still improves the M & A market?

KK › The succession question, or rather lack thereof, has been driving the Polish M & A market for several years. Ever since it began to be discussed publicly, lack of succession has become a very credible reason for companies to look for new owners. On the one hand, an entrepreneur considering selling a company for this very reason openly declares that after many years of hard work he would like to do something else or just get some rest, on the other hand there are usually people still in their prime, who are not forced to sell the company "here and now". The conversation has been going on for a few years and there is a lot of arguments in favour of a statement that in 2018 we may hit a peak point of transactions resulting from the entrepreneurs' problems with succession.

TP › To what extent is stock exchange still an appealing form of selling a business? In recent years, we have clearly seen more delistings than debuts.

KK › This trend may very well continue, for now. Firstly, our stock market in recent years has not grown as much as other foreign exchanges and a large proportion of companies is still priced attractively (i.e. cheaply), which may encourage investors to carrying out takeovers and withdrawing these entities from the stock exchange. One should remember the reasons for why many of these quasi-private companies (where the founder still remains the largest direct or indirect shareholder) are listed on the stock exchange. Such companies went public in order to find capital for development, a cause which in the era of cheap money lost its raison d'être. Secondly, the companies and their representatives have recently been burdened with additional duties and restrictions regarding access to information – the regulatory environment has become significantly more difficult. Managers face very high penalties for violating the regulations. Concerns regarding this subject are shared even by firms that do not change their ownership structure, let alone entities that get new, controlling private investors, who usually has ambitious development plans, which he does not want to announce in detail, ex ante, to the whole market. Considering all the above, no wonder that delistings occur often than debuts.

TP › Which sectors in Poland are the most attractive for the receiving companies?

KK › Not much has changed for years in this matter. FMCG, media, IT and other service sectors, including financial sector, are quite interesting. In my opinion, the latter has a very large growth prospect, much larger than in Western Europe. We can see that investors, including foreign investors, are increasingly interested in this type of assets. Recently, there were also many transactions in the packaging industry. This is another sector that benefits from the excellent economic situation in Poland. Thanks to significant investments in the modern machinery fleet and cheaper labour, it can effectively conquer the markets of the "old EU".

TP › Are there any expected mergers and acquisitions in the regulated sectors?

KK › Even if they are, they will be initiated by the state. However, due to a large number of risks, assets from these industries do not enjoy much interest from private investors. Although it must also be noted that various types of risks may also affect the private sector, as exemplified clearly by the Sunday trading ban.

TP › Can we expect at least a few "mega acquisitions" this year?

KK › The Polish market is still very fragmented. Large transactions in course of which the purchase of a given company would give the buyer a powerful position on the market are a rarity. Therefore, Polish companies and Poland-based PE funds carry out the majority of acquisitions of our local entities. Many of such transactions are motivated by attempts at consolidation of the fragmented market, which may be a risky strategy for a foreign investor who has not entered the Polish market yet. In particular if we are talking about a company or sector focused primarily on the Polish market. If the company does not operate in Poland, and it buys, for instance, a 6th or 7th company in a given sector, and will not be able to carry out any add-on transactions, i.e. buy another company from the sector, it is very unlikely that it will succeed in this market. In my opinion there will be no more than two or three mega-transactions this year. They will generate a lot of media noise, but the vast majority of acquisitions, as every year, will fall into the mid-cap category.

TP › Are foreign investors showing increasing interest in Polish assets?

KK › Yes, they are. And there are many indications that the interest will continue to grow, but, as I mentioned above, the investors encounter a number of restrictions. We often advise such investors, and we see that they are not able to find a takeover target that would meet their aspirations. Brexit can improve the situation, because it is possible that some investors will withdraw from the British market and look for more interesting options. There is also an increasing interest in regional assets from Asian investors, mainly Chinese, although there are problems, mainly the time needed to make decisions and convincing such entities that investing in Poland is a good first step, for instance, on the way to operating in the European Union. KPMG, of course, is present on the Chinese market, so reaching these potential investors is not a problem for us. But it takes just a few days of working together with colleagues in Shanghai or Beijing to notice that the entire region of China and Southeast Asia offers a plethora of investment opportunities. Additionally, they are located so much closer, so if investor's strategy does not feature plans for expansion into Europe, it will be difficult to interest the company in investing in Poland. Also, the global expansion strategy of such an investor will not help us either, because then the investor will compare the benefits of investments in Poland with those of investing in the US. And that may not bode well for us.

TP › Apart from Poland, which markets in Central and Eastern Europe are interesting from the M & A perspective?

KK › Romania is becoming increasingly important due to the scale of the local market and, it seems, thanks to shedding the image of a country that was non-transparent and plagued by corruption. The remaining countries in the region are definitely smaller, less populated and have lower potential for M & A market development. It also seems that a smaller inflow of M & A investments to these markets resulted in a relatively large scale of green field investments, manufacturing goods for global or pan-European markets, as local authorities tried to attract such investors at all costs.

TP › Is there an increasing number of Polish companies that decide to expand abroad?

KK › Yes, that is the trend. Many enterprises have already grown so much that Poland became too small for them. Or they are so well organized and have such a competitive product that they decide to make this bold move. In 2017, we had over 20 such domestic companies that successfully finalised international transactions. There are different models and reasons for such decisions. Sometimes, for example, a company provides a very good product, but it is not able to push its way through and promote it sufficiently on foreign markets. Then, it can acquire a local competitor and offer its original products under the competitor's brand. In my opinion, in order for such an investment to result in expected growth and synergies, and not affect the condition the Polish parent company, the enterprise which makes such an acquisition should be organisationally mature, have a precise plan of action and management on site to support its initiative. Finding funds to finance such a takeover is the easiest part.

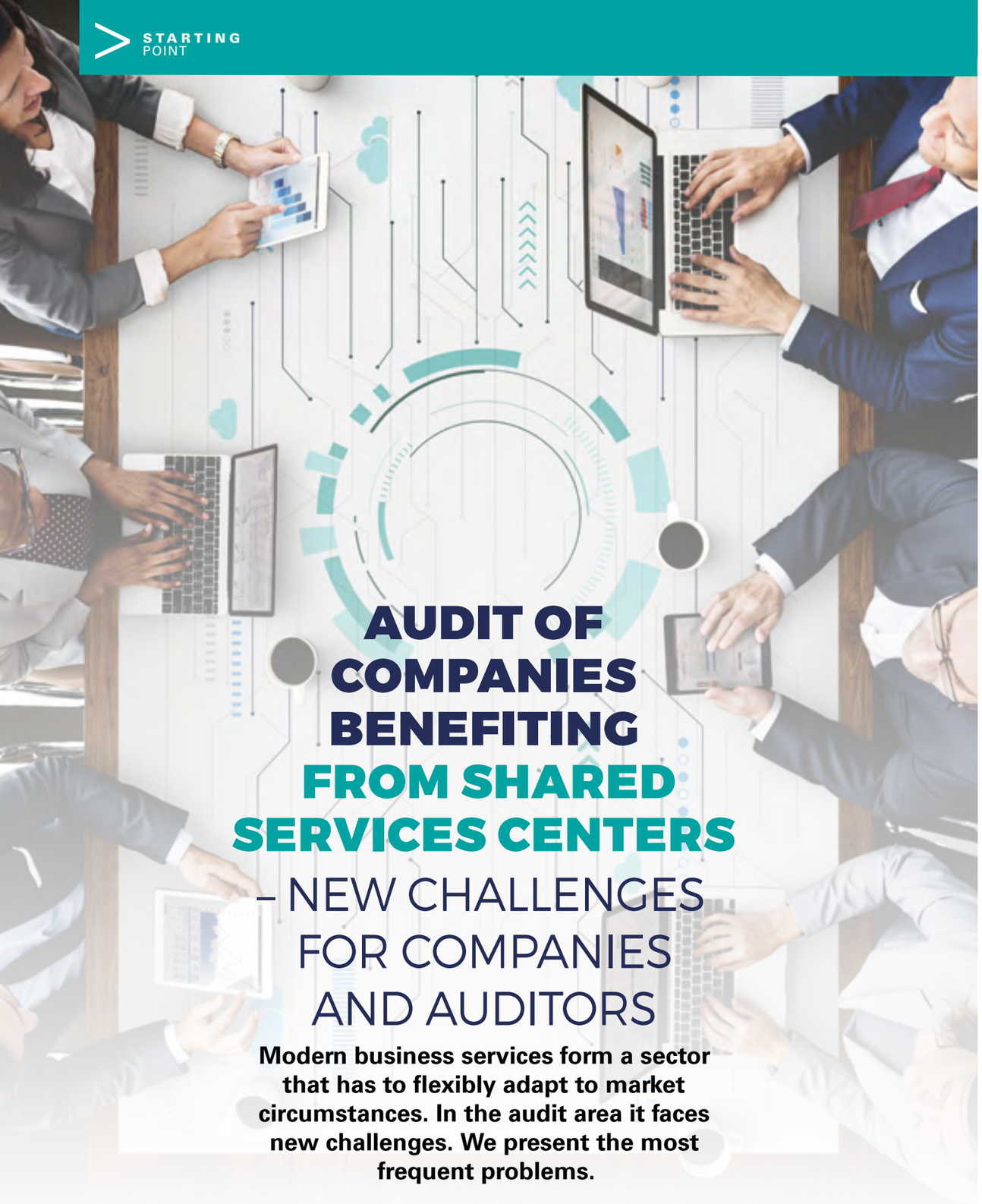
TP › Finally, please tell me how the asset valuations in Poland are shaping up?

KK › They have systematically increased for the last two or three years, which paradoxically makes it increasingly difficult for the parties to reach an agreement. If the difference in price does not exceed, let's say, 15%, then such transaction may still be done. However, if the discrepancy is significantly higher, the agreement is very difficult to achieve. It seems that in this area especially PE funds may encounter a very crucial problem here. Who cares if the acquired entity is attractive and offers development potential, when a high initial price negates the actual possibility of reselling the asset and getting the expected rate of return a few years later?

TP › Thank you for your time. ■

RANKING OF FINANCIAL ADVISORS SPECIALISING IN M & A TRANSACTIONS

KPMG again is the leader of the Financial Advisors Ranking on M & A Transactions in Poland according to Thomson Reuters. In 2017 alone, KPMG advised on 9 deals, and additionally ranked first (per the number of transactions) in terms of transactions completed in Poland in the last 10 years.



AUDIT OF COMPANIES BENEFITING FROM SHARED SERVICES CENTERS – NEW CHALLENGES FOR COMPANIES AND AUDITORS

Modern business services form a sector that has to flexibly adapt to market circumstances. In the audit area it faces new challenges. We present the most frequent problems.

A dynamic industry

In contrary to the number of economists predicting a slow decline in the business services sector in Poland, as it was supposed to lose its competitive edge against countries with lower labour costs, this sector is still developing very dynamically. According to the latest industry reports, there are currently over 1,100 business service centers in Poland with over 244,000 employees (a 15% increase over 2017). Additionally, the sector is still growing and it is expected that by 2020 employment will exceed 300,000 people.

HUBS OF MODERN BUSINESS SERVICES

In large centers, such as Kraków, Warsaw or Wrocław, over 40,000 employees are already working in the business services sector. Shared service centers are also present in other cities, where the number centers and the level employment in this sector show an upward trend. Currently, the fastest-growing new centers include Gdańsk, Sopot and Gdynia, Łódź, Poznań, Bydgoszcz and Rzeszów.

Accounting and financial services make up approximately 20% of the business services sector. We include both shared service centers(SSCs) that provide specified services for the internal needs of a given corporation, as well as centers run by specialized global business services companies that offers outsourcing of accounting and financial processes (BPO).

An increase in competence

Along with IT services, financial and accounting processes were among the first to be moved from groups' headquarters to shared service centers, leading to significant development of these services over the past years. Initially, the SSCs role in the financial and accounting areas was limited to simple tasks: purchase invoices and payments, transactions recording and the simple management reporting. In subsequent years, the centers have taken over more tasks and responsibilities from headquarters. SSC took responsibilities for sales processes, collection of receivables, preparation of financial reports as well as extensive management reporting (e.g. preparation of operational budgets and cash flow forecasts). This involved the need to expand teams and employ an increasing number of qualified specialists. At the same time, the knowledge from the head office was transferred to SSC, which released the need for finance and accounting specialists in groups' companies, replacing them with equally qualified but cheaper staff in Poland. Currently, there we can see situations, when there is no financial and accounting staff at the local level and all functions are performed in SSCs or the local finance team is very limited and it works on data provided by SSC.

Along with IT services, financial and accounting processes were among the first to be moved from groups' headquarters to shared service centers, leading to significant development of these services over the past years.

Challenges for auditors

The change in the business model introduced by global corporations and the centralisation of most of financial and accounting functions in shared service centers required also a change in auditors' approach to auditing financial statements of such groups. It is now more common these clients expect that the audit will be carried out in the SSC, i.e. the place where the accounting processes are located, including people with knowledge of the company and its processes, responsible for keeping its financial books and preparing financial statements.

This required from the auditor to change the concept of an audit completely. Previously, the audit work was carried out at groups' headquarters, where the audit team performed most of the procedures related to the audit of the consolidated financial statements. In addition, local audit teams from countries, where the group subsidiaries were located, performed audits or reviews of group reporting packages and audited statutory financial statements.

At present, most audit procedures can be performed at a SSC, in one place, by a single audit team that cooperates with the SSC and is able to conduct audit for both the group and for statutory reporting purposes. The results of this work will be reported to the group auditor and local audit teams responsible for statutory audits. It all depends on the stage of SSC 'development' and the auditor's approach.

And herein lies the problem. Unfortunately, International Standards on Auditing (ISAs) do not address directly the concept of auditing capital groups using shared service centers and do not provide guidelines in that regards. Therefore, the auditors must rely on the general framework of ISAs and apply them accordingly, taking into account the client's specific character and the level of competence of a given SSC. This involves many problems, the most pressing are:

- proper planning of the audit work,
- allocation of work between the group auditor and the SSC auditor,
- cooperation with the SSC.

STARTING
POINT

SPECIFICS OF PROBLEMS ARE ELABORATED IN THE FOLLOWING POINTS.

I Audit planning

In order to plan an audit properly, it is necessary to have very good understanding of the company's operations, knowledge of significant events and transactions incurred during the year, information on key accounting issues, processes, and be familiar with the system and quality of financial reporting. In the case of capital groups using SSCs, this knowledge is largely divided between the SSC and the company. In addition, in the SSC this knowledge is shared among many employees responsible for various processes in a given company.

The key auditor is responsible for the appropriate planning of the audit, including the identification of risks, setting the materiality threshold, determination of significant accounts and planning of relevant audit procedures. As a rule, the key auditor is a partner in an auditing company, which is responsible for the entire group audit and signs the audit report on consolidated financial statements. In the case of capital groups using SSCs, it may be a partner from an office located in another country, who will rely largely on information and audit documentation obtained from an audit team working in the SSC.

II Allocation of work between the group auditor and the SSC auditor

The most common split of responsibilities between the SSC and the headquarters, used in shared service centers, assumes that the SSC is responsible for the balance sheet accounts, while the local finance team is responsible for the profit and loss accounts and specific accounts used for recording specific transactions resulting from local regulations. The problem is that this split of responsibilities is often not formalized, and in the case of many SSCs, we face a situation where the responsibility for a given account is shared, which means that it contains entries made both by SSC employees and the local finance team.

The lack of a formal and clear split of responsibility between the SSC and the headquarters complicates the appropriate allocation of work between the group auditor and the SSC auditor. This prevents the execution of all audit procedures in one place, which significantly extends the time of the auditing process.

According to audit standards, the key auditor is responsible for the appropriate planning of the auditing procedures that address the identified audit risks. Therefore, he should have a very good understanding of the client's accounting and financial processes. In the case of audits involving shared service centers, this knowledge is usually not available to the key auditor and he has to use rely on information obtained from the SSC audit team, which has the appropriate know-how and knows which audit procedures and in what extend can be performed at the SSC. As a consequence, the SSC audit team is forced to prepare the audit instructions de facto for themselves, consult them with the SSC and then agree with the group auditor.

The lack of a formal and clear split of responsibility between the SSC and the headquarters complicates the appropriate allocation of work between the group auditor and the SSC auditor. This prevents the execution of all audit procedures in one place, which significantly extends the time of the auditing process.

The large scale of SSC projects requires from audit firms to involve more employees, which may have negative impact on a proper allocation of teams on other projects.

Both the client and the group auditor expect the audit conducted at the SSC to be more effective than audits performed locally at each subsidiary of the Group. Therefore, the goal of the SSC audit team should be to prepare the most standard audit procedures that can be performed for all companies served by SSCs. In addition, internal controls, after ensuring their standardization, should be tested on shared samples for all companies served by a SSC, which will significantly reduce the audit process.

Unfortunately, this approach is often misunderstood and opposed by local audit teams. Local auditors often require additional, specific procedures for their companies and disagree with a homogeneous approach to control testing.

III Cooperation with the SSC

Audits carried out in a SSC differ significantly from the standard audits carried out at the local level at individual subsidiaries of the Group.

First of all, the scale of a SSC audit is much larger. Currently, shared service centers can support several dozen group's subsidiaries , which are subject to audit requirements. Therefore, in order to meet the reporting deadlines set by the group, SSC auditing teams include a dozen or more people. This causes logistic problems in the centers – how to find enough room for such a large audit team and plan the work of regular employees so that it does not have a negative impact on the daily operations of the center. The large scale of SSC projects requires from audit firms to involve more employees, which may have negative impact on a proper allocation of teams on other projects.

Secondly, SSCs often operate based on PDO (Process Driven Organization) model, which means that SSC employees are divided into teams specializing in a specific process (for instance, inter-company transactions, fixed asset management, debt collection), which they perform for all companies served by the SSC. As a result, SSC employees have a good knowledge about a certain process, but are less informed about the company's overall operations. In other words, if the PDO model is implemented by a SSC, it is difficult to find a person who would correspond to the role of a financial controller or financial director in a standard company and who would have extensive knowledge of the company's operations, transactions and finances, and be able to comprehensively answer auditors' questions. This makes it difficult for SSC auditors to gain sufficient knowledge about specific transactions or operations and requires contact with numerous SSC employees but also often with employees in the group's headquarters.

Evidently, an audit of capital groups supported by shared service centers creates new challenges for auditors and their clients. Planning and performing such audits is a complicated and time-consuming process that requires very good communication and on-going cooperation between a lead auditor, the SSC's auditing team, the SSC and the group's headquarters.

Fortunately, all parties are beginning to realize this necessity. Currently, we can notice increased cooperation between auditors, SSCs and a group auditor. Especially, as there is no turning back, because the centralization of financial and accounting processes in SSCs will continue and the audit sector has no choice but to adapt to this. ■

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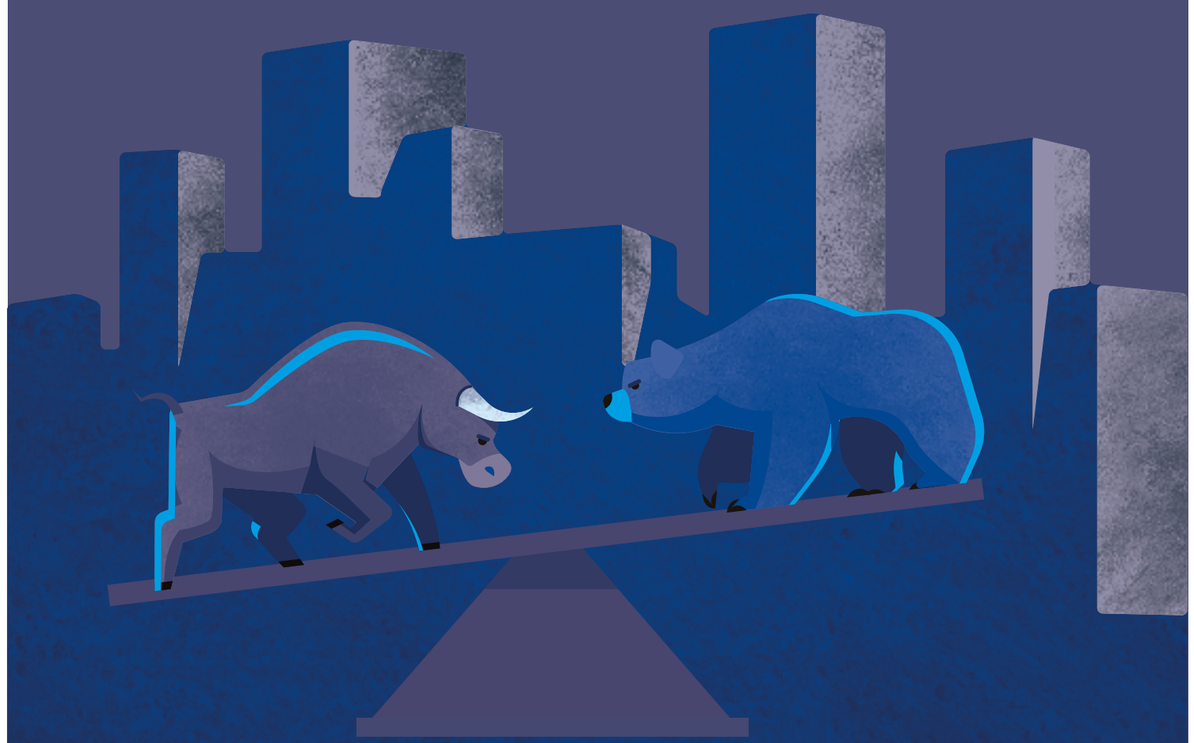
Over 18 years of professional experience. He manages team on audits of separate and consolidated financial statements prepared in accordance with Polish and international financial reporting standards. He conducts training courses on IFRS and specific accounting issues. Specialises in audits of shared service centers, including assistance to a group auditor with audits of the large capital groups that use SSC or BPO. He is a Certified Auditor and a Member of the Association of Certified Chartered Accountants (ACCA).

TENDER OFFER PRICE VERSUS MINIMUM PRICE. HOW HIGH SHOULD A PREMIUM BE IN ORDER TO GUARANTEE A SUCCESSFUL TENDER OFFER?

Market regulations clearly specify the minimum required price that should be offered in a tender offer for company's shares, however the bidders usually pay much more than the minimum required. How significant are these premiums and what do they depend on?



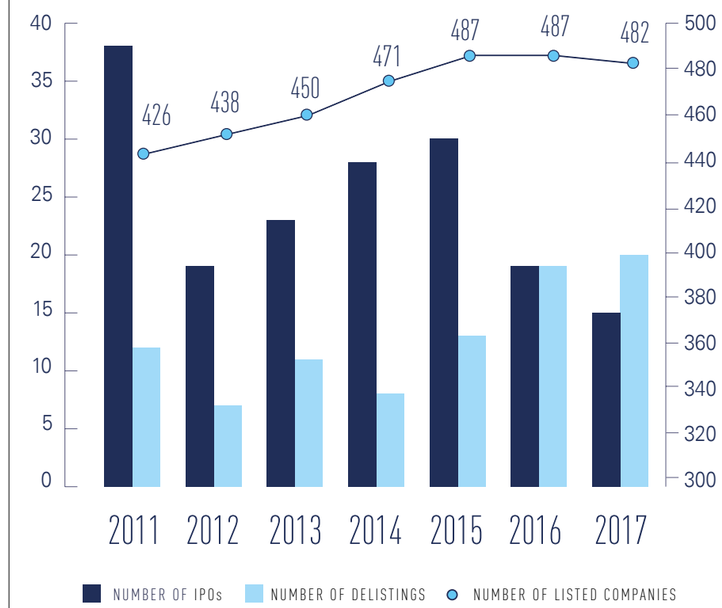
KPMG in Poland decided to look into premiums over the minimum tender offer over minimum prices on the Polish stock market. In particular, the analysis concerned the relations between the amount of such premiums and the planned takeover or a delisting of a company. In addition, it presents increasingly common situation when an independent entity is involved, whose role is to provide an opinion on whether the price in the tender offer corresponds to the fair value.

2017 was a record year in terms of delistings of public companies from the Warsaw Stock Exchange, as 20 companies exited the main floor. Considering the fact that there were only 15 Initial Public Offerings (IPOs) that year, for the first time since 2003 we experienced a decrease in the number of companies listed on the WSE main market.
The growing number of company's delistings from the public market has been a trend on the Polish market since 2014, which especially increased in the past two years . The most frequently quoted reasons for leaving the Polish stock exchange include burdensome information requirements, low stock valuations and conflicts with minority shareholders. At some point, the founders, who often own large blocks of shares and the management of listed companies start to see the increasing number of flaws in the public company status and fewer advantages that might justify the remaining on the stock market. What costs, however, should one expect to face when trying to leave the market in an effective manner?

The growing number of company's delistings from the public market has been a trend on the Polish market since 2014, which especially increased in the past two years .

Chart No. 1

The number of companies listed on the WSE main market in 2011-2017



SOURCE: KPMG ANALYSIS BASED ON THE DATA FROM THE WARSAW STOCK EXCHANGE

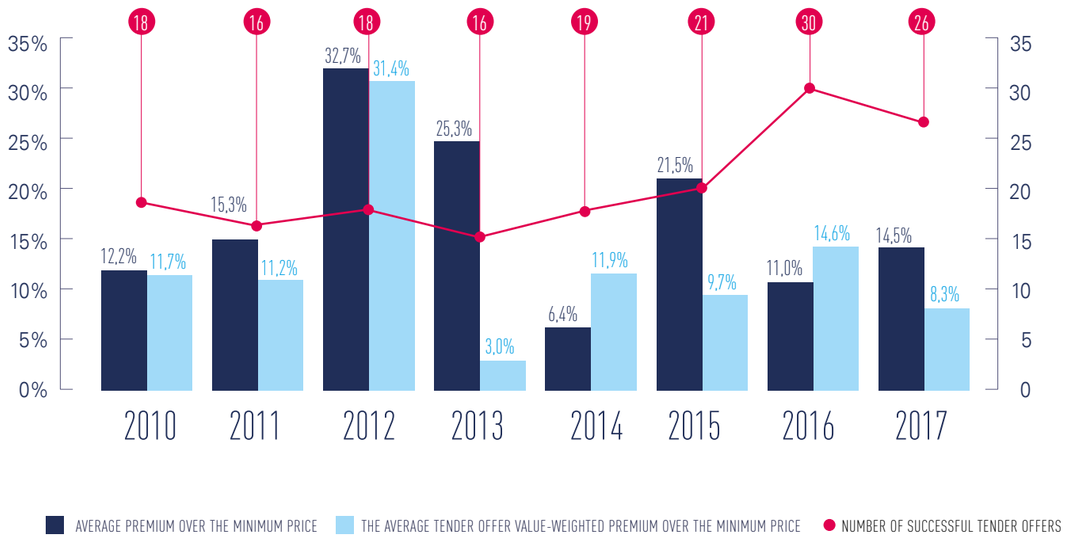
KPMG in Poland analysed 210 completed tender offers announced in Poland between January 2010 and December 2017, 88 of which were carried out with an intention to delist the company from public trading. In the analysed period, nearly 80% of tender offers were successful, and the bid value-weighted average premium paid in relation to the minimum price required by law was 12.3%. Over the last few years, one could see huge fluctuations in amount of premiums paid in the case of successful tender offers. The record-setting premiums were paid in 2012, when the average premium above the minimum price was approx. 32%, mainly due to such transactions as the tender offer for Eko Holding S.A. (a 82% premium), when two private equity funds competed for the acquisition of the company. In 2012 there were several other tender offers with record premiums, including the one announced by Rabobank International Holding B.V. for shares of BGŻ S.A., in which the bidder offered a premium amounting to 53%, a tender offer for Zelmer S.A. (a 32% premium) or PEP S.A. (26%). In the following year, the value-weighted average premium was only 3%, while the arithmetic average exceeded 25%, which was a proof that much higher premiums were paid in the case of smaller tender offers, such as the one for shares of Próchnik S.A. (the proposed premium in this case amounted to 170% of the minimum price, but the value of the entire tender offer did not exceed PLN 100,000) or the tender offer for Mispol SA shares. (a 125% premium, with the tender offer valued at PLN 9 million).

1 In accordance with the requirements set out in the Act on Initial Public Offerings, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies, the price proposed in the bid cannot be lower than the average market price in the six months preceding the announcement of the bid, and if the bid results in exceeding 66% of the total the number of votes in the company also cannot be lower than the average market price from the period of three months immediately preceding the announcement of the bid. If it is not possible to determine the price in accordance with the conditions set out above, or if restructuring or bankruptcy proceedings have begun in the given company, it may not be lower than their fair value. The share price proposed in the bid cannot be lower than the highest price of the shares of the company being the subject of the bid, paid by the bidder or other parties specified in point 14 of the Act, or their subsidiaries or dominant entities paid within 12 months before the announcement of the bid.

In 2016-2017, there was a significant number of tender offers in which the initially offered price did not gain shareholders' acceptance, therefore increasing the price was necessary for the tender offer to succeed.

Chart No. **2**

Average premium paid over the minimum price in successful tender offers in 2010-2017



SOURCE: KPMG ANALYSIS BASED ON PUBLICLY AVAILABLE INFORMATION

In 2014-2017, premiums paid were significantly lower, stabilizing at an average level of 10.7% in the case of the value-weighted average and 13.3% in the case of the arithmetic average.
2016 turned out to be record-breaking in terms of the number of successful tender offers, while 2017 was the first year since 2013 when there has been a drop in number of successful tender offers (year-to-year), which could also result from the lower value-weighted premium, which was only 8.3%. The premiums paid in Poland are still significantly lower than those on the US market, where the price in the tender offer is usually within the range of 20% and 40% above the current stock price[2].

The initial price is often not enough

In 2016-2017, there was a significant number of tender offers in which the initially offered price did not gain shareholders' acceptance, therefore increasing the price was necessary for the tender offer to succeed. 2012 was the record year in that regard, as the average (tender offer value-weighted average) increase of the offered price was nearly 23%, which meant particularly that the premium had to be doubled in relation to the initial tender price. The tender offer for shares of Eko Holding SA is a good example, where the acquiring party finally raised the proposed price from PLN 4.10 per share to PLN 7.00 per share, i.e. up to 70%, mainly due to the competitive bid.

Another interesting example from the same year is the attempt at hostile takeover of Zakłady Azotowe in Tarnów-Mościce S.A. by the Acron group from Russia. The investor's intention was to take control over the company and achieve 66% of the share capital. To achieve this, the bidder initially offered 18% of the premium above the minimum price, and then increased the original offer from PLN 36 to PLN 45 per share, which meant a nearly 50% premium in relation to the minimum price. Despite such difference in the offered price, the tender offer was only partially successful, and not only due to the economic reasons, as the bidder purchased only 12% of the company's shares in a tender offer. This example supports the view, that when the bidder aims to take the control over the company, the tender offer may fail even despite a relatively high premium, as confirmed by the following analysis of tender offers for majority stakes from the 2010-2017 period. With few exceptions, a certain regularity in paying higher premiums can be noticed when the intention is to gain the controlling interest in a company. As expected, in the majority of the analysed years the percentage change in the bidding price was higher when taking control over a company was considered. Chart no.2 shows that in different years the bidders were forced to increase the price per share significantly in order to achieve the assumed goal of taking over the controlling interest in the acquired company. The initial price was increased by the bidders in 21 out of 65 cases in case of a successful takeover (which is almost every third case).

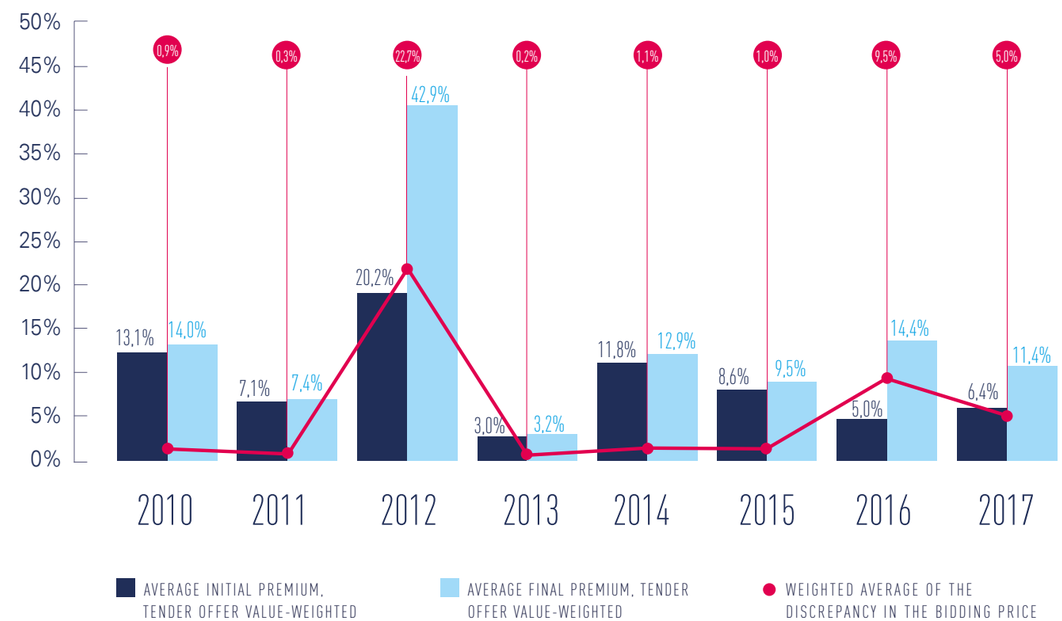
On the basis of our analysis, it was noticed that the intention to delist a company from the stock exchange requires a higher premium.

Premium for leaving the stock market

On the basis of our analysis, it was noticed that the intention to delist a company from the stock exchange requires a higher premium. In 2010-2017, the average premium in tender offers with the intention of delisting was almost twice as high (25.8%) as in the case of tender offers where delisting was not considered (14.3%). This trend also occurs in the case of a value-weighted average, however the difference in this case is much lower (2.4 percentage points), as shown in the chart below, which means that much higher premiums paid in the case of delisting plans from the stock exchange are significant in smaller tender offers. »

Chart No. **3**

Analysis of premium in tender offers for majority stake in 2010-2017

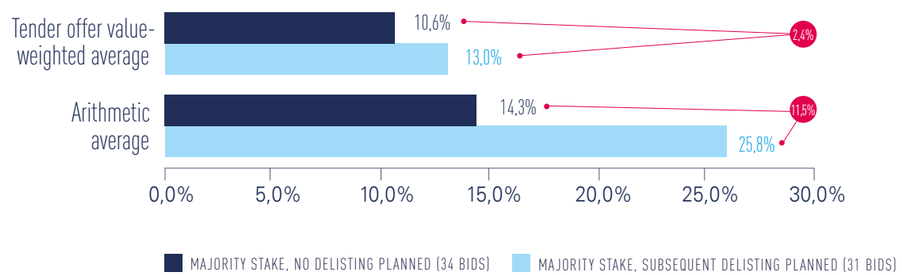


SOURCE: KPMG ANALYSIS BASED ON PUBLICLY AVAILABLE INFORMATION

2 Marvin Dumon, Why Public Companies Go Private, https://www.investopedia.com/articles/stocks/08/public-companies-privatize-go-private.asp#ixzz56Pv58jvG, 16.02.2018.

Chart No. 4

The difference in premiums paid in tender offers for majority stake depending on the plans to delist the company from the stock exchange, 2010-2017



SOURCE: KPMG ANALYSIS BASED ON PUBLICLY AVAILABLE INFORMATION

Premiums and the *Fairness Opinion*

In case of tender offers for 66% stake or more, the Act requires that the management board of the target company issues a statement whether the offered price reflects the fair value of the company. Management boards often face a conflict of interest when the bidder already owns shares in the company. In such cases, in order to increase the credibility of their statement, management boards choose to seek independent opinion on the financial conditions of the tender offer – Fairness Opinion. In 2016 and 2017, such opinions were made public in nearly a third of all cases (almost a half of all opinions on tender offers issued since 2009), a ratio that, though closer to that found in Germany, remains nearly two times lower than in Switzerland, and over three times lower than in the US. The analysis indicated that in the analysed period premiums paid in case Fairness Opinion is issued (11.4% in case of value-weighted average) were lower than in the case of successful tender offers without such opinion (13.0%). A Fairness Opinion obtained from an independent entity often makes a good argument for shareholders to respond to a tender offer. A positive Fairness Opinion can increase a chance of minority shareholders to support the statement of the board and accept a lower premium in relation to the minimum required price (as compared to the situation where such opinion is lacking). This might be due to a lesser confidence in the statement of a board that refrains from subjecting the company to independent analysis and assessment. The reputation of the advisers and their independence can also play a major part for shareholders who are uncertain if the price offered for their shares is fair. Once the management board receives an independent opinion on the price of shares involved in the tender offer, the information is made public, which significantly increases the weight of the board's statement from the shareholders' perspective. Analyses conducted by KPMG in Poland clearly prove that for a tender offer to succeed, the price offered should be higher than the minimum required price. Though there were cases where premiums exceeded 50%, successful tender offers for majority stake of listed companies typically require an offer between 10 and 20% over the current value of the stock. However, this often requires increasing the initially offered price in the tender offer . Convincing investors to sell all of their shares in order to delist the company from the stock market typically involves even greater expenses. Higher premiums play a particularly important part in the pursuit of delisting of small-sized entities from the stock market.

The Act requires that the management board of the target company issues a statement whether the offered price reflects the fair value of the company.

Table No. 1

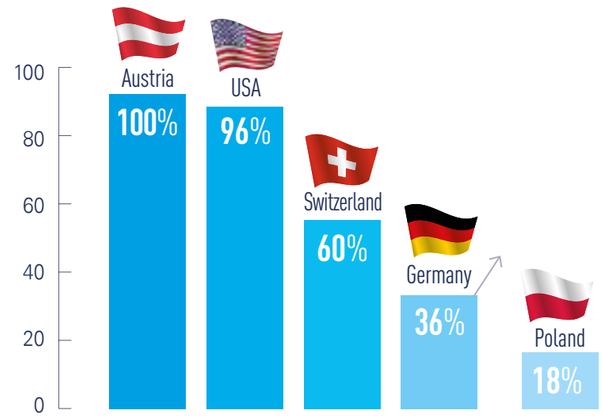
Number of *Fairness Opinions* issued in Poland per announced tender offers in the 2009-2017 period.

YEAR	NUMBER OF TENDER OFFERS	*FAIRNESS OPINION*	% OF *FAIRNESS OPINION* IN THE TOTAL NUMBER OF TENDER OFFERS
2009	18	1	6%
2010	25	5	20%
2011	17	1	6%
2012	25	8	32%
2013	25	1	4%
2014	23	1	4%
2015	27	5	19%
2016	35	11	31%
2017	33	9	27%
TOTAL	**228**	**42**	**18%**

ŹRÓDŁO: KPMG ANALYSIS BASED ON PUBLICLY AVAILABLE INFORMATION

Chart No. 5

Percentage of tender offers in which the management board used the *Fairness Opinion* in 2009-2017



SOURCE: KPMG ANALYSIS BASED ON PUBLICLY AVAILABLE INFORMATION

Conclusion

The analysis indicates that for a tender offer to succeed, its value cannot be assessed based solely on the minimum required price. One has to reckon with the cost of the premium expected by minority shareholders. The premium can be higher if the tender offer involves the intention of taking control over the company, when shareholders demand that the bidder shares with them the anticipated synergy gains. If the bidder intends not only to gain the controlling interest in the company, but also to delist it from the stock market in the future, minority shareholders usually require even higher premiums. On the other hand, in order to slightly decrease the cost of the transaction, the bidder may seek an opinion from an independent adviser, who will objectively assess the conditions of the bid. It has been observed that in cases where the management board hired an independent adviser to issue Fairness Opinion, the premium was somewhat lower than when the response to the tender offer was based merely on the internal opinion of the management board of the target company. ■

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PREPARING A COMPANY FOR A CYBER ATTACK

In 2017, as many as 82% of Polish companies recorded a cyber attack. It seems, therefore, that it is only a matter of time before any company's secured information systems can be compromised. Boards and employees responsible for IT security in companies do not face the question of whether, but rather when the cyber attack will occur. Implementing security procedures in companies requires the cooperation of many departments, including IT, security, communication, legal, and human resources departments, but also the involvement of top-level management.

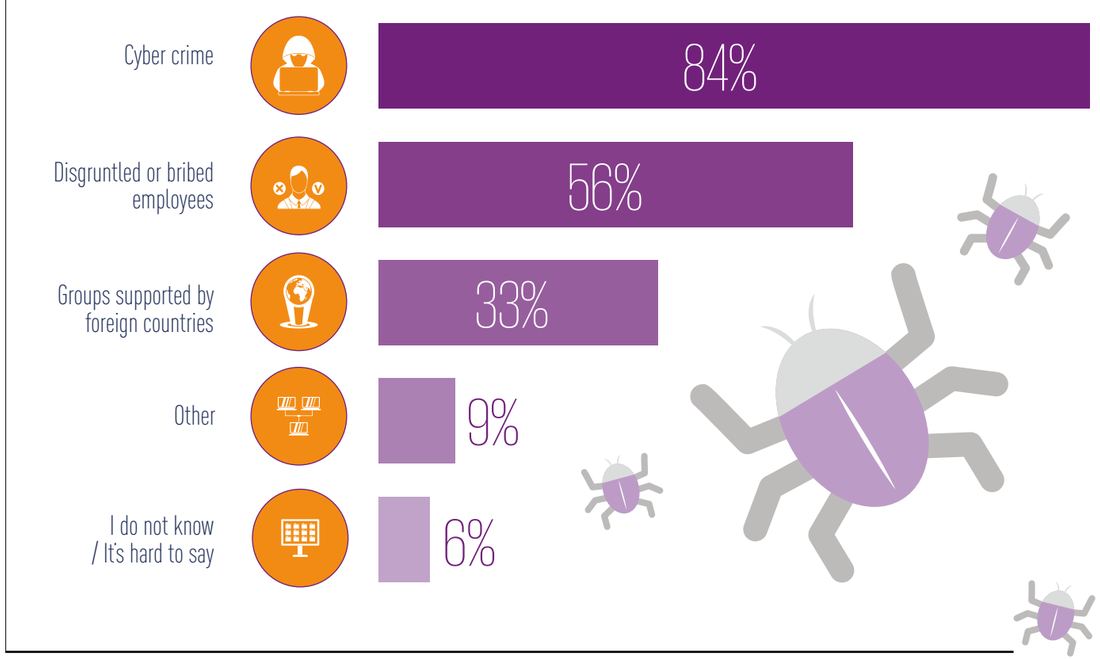
According to KPMG's "Cyber Security Barometer" study, as many as 82% of Polish companies reported a cyber attack in 2017. The companies have clearly indicated that there has been a significant rise in cyber crime. Considering the scale and complexity of today's cyber threats, the question is no longer whether a cyber attack will take place, but when will it occur. Companies are most concerned about malware, social engineering, as well as attacks using the security vulnerabilities of applications. Polish companies stated that the most frequent source of cyber attacks were organized criminal groups (per 62% of respondents) and individual hackers (61%). A dissatisfied or bribed employee, a number one threat in previous studies, is no longer considered the highest risk.

Companies in Poland have begun to recognize that it is impossible to protect against cyber attacks, so preparing for its early identification and proper response are key measures. The KPMG study shows that the above issues were indicated as top priority investment areas at present. This is a very optimistic sign, because the average time between detecting a hacker's presence and the actual time when the hacker takes over control of the company's infrastructure is still over six months.

The question is no longer whether a cyber attack will take place, but when will it occur. Companies are most concerned about malware, social engineering, as well as attacks using the security vulnerabilities of applications.

Figure 1

Which of the following groups or individuals pose an actual threat to businesses?



The cyber attack response procedure can be divided into two basic stages – the attack analysis, aimed at understanding what happened and the right response, i.e. stopping the attack, limiting its consequences and repairing the damage.

How to prepare for a cyber attack?

A company cannot be perfectly prepared for a cyber attack. Each attack is different, so there is no single method or procedure for defense. Many organisations feel they have created an informal procedure for responding to incidents, which, among other actions, results in assigning responsibility to IT security and the continuity of business procedures. Unfortunately, the practice shows that the lack of a previously developed, documented and tested procedure leads to many ineffective decisions in the event of an actual cyber attack.

It is very important to properly assign responsibility and authorise the team that handles the incident to make decisions without consulting the management, as such consultations may introduce unacceptable delays. Erroneous decisions during a cyber attack can cost a company dearly, and sometimes even be crucial for its future.

A great deal of attention should be paid to implementing the security incident response procedure, especially in large enterprises. The biggest challenge is the fact that many departments – including IT, security, communication, legal, human resources – need to cooperate in order to achieve this goal. The implementation of an efficient process can therefore take months. It is also practically impossible without the involvement and active support of top-level management.

It is also advisable to establish cooperation with specialized external companies in many areas of the procedure. According to the KPMG study, the majority of Polish companies (71% of respondents) use outsourced security services. The most often outsourced service (in 49% of companies) is support in response to cyber attacks. Due to the fact that serious security breaches often occur during time periods of low employee availability (weekends, holidays), it is worthwhile ensuring the availability of an external partner with a contract that would guarantees this.

Figure 2

Cybercrime - main threats

Figure 3

Security functions / processes outsourced to external suppliers

A cyber attack cannot be reduced to direct financial losses. It may also result in damage to a brand, which is difficult to estimate. Therefore, it should be obvious to include PR specialists in the cyber attack response team.

What should we remember about?

The purpose of the security incident response process seems simple. However, it is worth considering at this stage, whether we want to track down and capture the hacker, or if we are only interested in getting rid of him from the network as quickly and effectively as possible. Depending on the way we define our goal, our procedures may be different, for instance in their scope of gathering evidence.

The cyber attack response procedure can be divided into two basic stages – the attack analysis, aimed at understanding what happened and the right response, i.e. stopping the attack, limiting its consequences and repairing the damage. The key dilemma here is how fast we should switch from the analysis phase to the active response. Practical experiences teach that removing the hacker from the network too hasty, before thoroughly understanding the scale and complexity of the attack, can cause the intruder to change his style of operation, hide in the infrastructure and resume unauthorized activities after some time. On the other hand, procrastination and prolonging the analysis stage can lead to costly effects of a prolonged cyber attack.

Another issue that should be thoroughly analysed, also in terms of changes in regulations, is the

obligation to notify the regulator about a cyber attack. In particular, if a personal data leak occurs, such notification will have to take place within 72 hours of attack detection. In various industries subject to specific regulations there may be additional requirements in this respect. A big dilemma is whether and when to inform law enforcement agencies. In case of some incidents, such reporting is not an obligation, and many companies complain that after the police starts to handle an incident, the company lose control over it, which may result in lengthening its termination time and incurs additional costs on the company.

A cyber attack cannot be reduced to direct financial losses. It may also result in damage to a brand, which is difficult to estimate. Therefore, it should be obvious to include PR specialists in the cyber attack response team. Practice shows that the best strategy when facing a cyber attack that breaches customer data confidentiality is full transparency and reliable communication as soon as possible. Professional communication about the incident can help you regain customer's trust that has been damaged by a cyber attack.

CONCLUSIONS

Please remember that a cyber attack can also bring some positives. As in every other sphere of life, failure is a great source of learning. When restoring the company's operations after a cyber attack, we must not forget to draw conclusions about what exactly has failed and what to do to avoid similar incidents in the future. The often used method of looking for a guilty individual and taking employment-related measures against him is usually not the best strategy. A person who has survived the cyber attack has gained an extremely valuable experience, which can not be recreated even by the best cyber security training.

Is a good procedure enough?
Implementing proper security measures is a process. Procedures for responding to cyber incidents should be implemented and constantly updated. The best way to convert them from theory to a real organization's readiness to face cyber criminals is to perform regular tests. The most common are scenario simulations: the company is subjected to a fictional cyber attack. Another often encountered form of testing is the so-called Red Teaming, or real attempts to breach the security of the company by a team of pentesters. It tests the organisation's ability both to detect an attack and to respond appropriately. Such action not only improves procedures and technical protection, but most importantly they it creates a culture of employee awareness in the field of cyber threats, which is the basis of the organization's resistance to cyber attacks. ■

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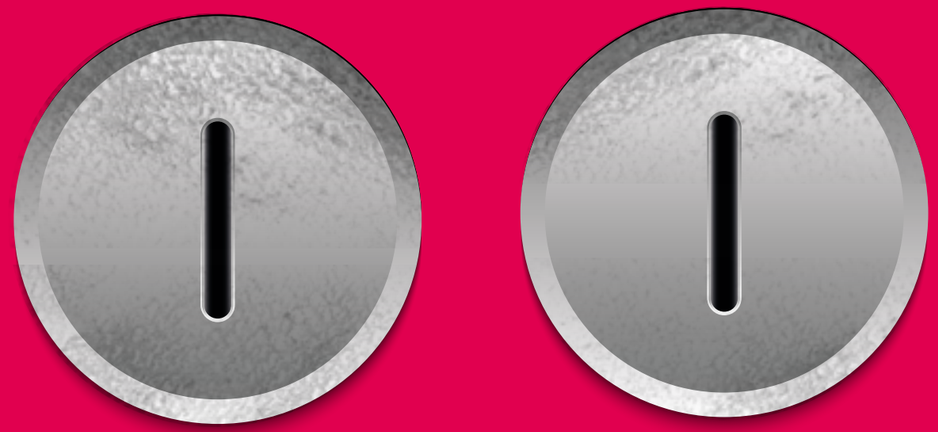
LEGAL ASPECTS **OF THE SPLIT PAYMENT MECHANISM**



The VAT split payment mechanism is a new instrument aimed to ensure greater stability of VAT revenue. New regulations introducing a split payment in VAT were made pursuant to the Act of 15th December 2017 amending the Act on goods and services tax and certain other acts (Journal of Laws of 2018, item 62). The provisions shall enter into force on 1st July 2018.

What is the VAT split payment system?

In essence, the VAT split payment mechanism means that a taxpayer who have received an invoice with the tax amount indicated, when paying the invoice, may divide the payment into two linked accounts: the amount the VAT amount, total or part of it, is paid directly to a dedicated VAT account of the supplier, and the net amount to the supplier's business account.
Despite splitting the payment into two separate accounts, it will be made in one transfer, as the payer will include the information necessary to make the payment in accordance with the split payment mechanism (tax amount resulting from the invoice, gross amount, invoice number and the VAT identification number of the supplier or service provider).

Who decides to use the split payment mechanism?

The buyer of goods or services decides to use of the split payment mechanism, while choosing to pay a specific invoice in this manner. If such a method of performance is selected, the seller is obliged to accept it, which does not exclude the specific arrangements between buyer and seller as to whether or not split payment is permitted manner of payment.

It seems that Paragraph 353.1 of the Civil Code allows for putting a contractual restriction on the freedom of buyer of goods and services regarding a split payment mechanism. According to the Ministry of Finance, the voluntary nature of using payment the split payment mechanism by the buyer does not mean that contracting parties can not, acting on the principle of freedom of contract, agree that the buyer will make payments using the current method, and not use the split payment mechanism (Minister of Development and Finance response of 8th January 2018 to the parliamentary interpellation No. 6431). Therefore, it will be legally permitted to place such provisions in the contract between the buyer and the seller, that would exclude a split payment.

We should assume that it will be also possible to stipulate in a contract that the buyer is obliged to make a payment without split payment method; this should be taken into account by suppliers of goods and services who will want to make use of the mechanism and protect themselves against buyers' freedom in selecting the method of payment of invoices. Placing the option to settle the invoice either using or excluding a split payment mechanism in the contract additionally means that suppliers will be entitled to add provisions in this respect to the general terms of contracts.

The buyer of goods or services decides to use of the split payment mechanism, while choosing to pay a specific invoice in this manner. If such a method of performance is selected, the seller is obliged to accept it, which does not exclude the specific arrangements between buyer and seller as to whether or not split payment is permitted manner of payment.

The VAT account

The introduction of a split payment results in a new type of bank account in the Polish legal system, i.e. a VAT account. In accordance with the amendment to the Banking Law, the VAT account will be created by a bank for each holder of a Polish zloty business account. The business account may be held only by legal persons, organizational units with legal capacity and natural persons engaged in a gainful activity. The creation of the VAT account will not require signing a separate contract with the bank and will be free of any fees and commissions.
The Act provides that the interest rate on a VAT account can be agreed upon by both parties. However, taking into account the fact that there will be no signing of a new contract regarding the VAT account, it is likely that a significant portion of these new accounts will not be interest rated. Entrepreneurs whose business accounts have been yielding interest up to now should check whether this will still be the case with their VAT accounts, so as to be sure that after 1st July 2018 all funds constituting payments to their accounts continue to earn interest. Unlike other accounts, the bank will not be required to inform the account holder about any change in the VAT account status.

Funds accumulated on the VAT account

Holders will be limited in using the funds on the VAT account. The Act provides for a closed list of situations in which the VAT account may be charged. A typical and acceptable one will be the transfer of funds from the account to the account of the competent tax offic, in order to pay due VAT. Charging the VAT account in order to transfer funds to the taxpayer's business account is possible only with the consent of the Head of the Tax Office.

The funds accumulated on the VAT account, and on the business account corresponding to the VAT amount indicated in the transfer information, must-not be subject to seizure of funds on the basis of a judicial or administrative enforcement order, unless enforcement or securing relates to VAT.

In accordance with the amendment to the Banking Law, receivables from the VAT account cannot be subject to collateral security. Therefore, it will not be possible to establish collateral on such accounts, and in particular: receivable pledges on these accounts.

Legal consequences

The new regulations will have a significant bearing on the financial liquidity of enterprises and in fulfilling their contractual obligations. For example, they will influence collateral contracts concluded by the entrepreneurs, such as a bank account pledge, a contract for collateral transfer or liabilities related to maintaining certain liquidity ratios. ■

The funds accumulated on the VAT account and on the business account corresponding to the VAT amount indicated in the transfer information cannot be subject to seizure of funds on the basis of a judicial or administrative enforcement order, regarding enforcement or securing receivables other than VAT.

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VARIOUS FACES OF *DUE DILIGENCE* IN FAMILY BUSINESSES

The company's legal audit, known as legal *due diligence* (LDD), is usually performed by the potential buyer and has many purposes that are linked to various consequences, some of which deserve special attention.

First and foremost, the party performing the audit comes into the possession of crucial information about the entity being examined. Even though the examination is governed by relevant confidentiality agreements, this does not change the very fact of disclosure of such data. Naturally, providing such sensitive data is reasonable insofar as the seller has a significant hope of selling the company. In other words – if the potential profit compensates the risk taken. Another important effect of a due diligence report is the identification of various irregularities in the audited entity that will, to a lesser or greater extent, have an impact on the terms of carrying out of the transaction. Notably, this impact may concern not just the sale price, but also the method of payment or the way of securing it, the rules and period of the sellers' liability, as well as the period during which, pursuant to the investor's expectations, the current management (owner) will handle the company's affairs.

Of course, in the legal sense, the seller who displayed all the irregularities may expect that the buyer, being aware of them, will not have any related claims in the future. However, the level of professionalisation of the company purchase process, as well as the options that have been worked out in the market practice, do not offer the seller much hope for comfort in this matter. The buyer, realising that the time of transaction is practically the last moment for them to discount the defined problems in the company being purchased, will do their best, with their advisers, to appropriately reflect this in the agreements with the seller. The higher the number of problems to describe, the more complex the agreement and its negotiations as well as the related costs.

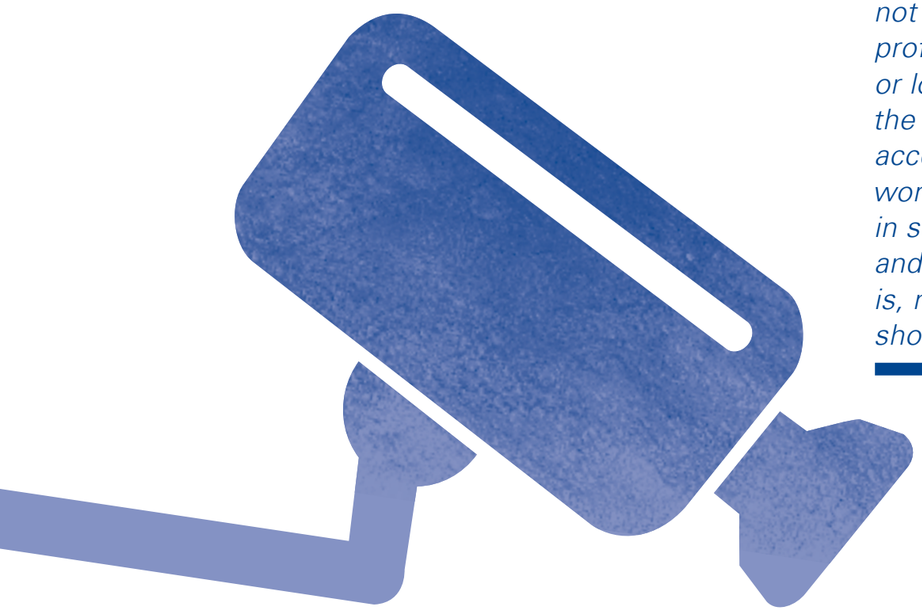
The specific nature of family businesses – *business first, then compliance*

Experience in advising family businesses provokes the conclusion that such companies have a far lower need for legal compliance than, for example, transnational corporations or public companies. This results from the acquired conviction that if a given process and the related costs do not translate into profit in the short or long term, and the risk of loss is acceptable, it is not worth to engage in such a process, and in the case it is, minimum effort should be made. This approach is often fully rational and further justified by the family businesses' operating model, in which key positions are often held by highly trusted persons; frequently such trust is strengthened by kinship.

However, the point of view of a potential buyer can be radically different. This mainly stems from the simple fact that the buyer will look at the acquisition target from a certain distance (in the case of a foreign buyer such distance will be even greater). Such an entity would find it much more difficult to trust assertions that, e.g., given that the existing irregularities have not hindered the company's development for the last 20 years, there is a low possibility these would constitute an obstacle to the functioning of the company in the future. One should rather expect a request to remove such problems or to adequately reflect this fact in the price or in the sellers' liability.

The issue of discrepancy in the approach of a family business and that of a potential buyer to the compliance with certain 'non-business-like' regulations is recently growing in importance in view of a legislative offensive of sorts on the part of the EU and Polish legislator, with the quintessential example in the form of RODO (GDPR) regulations. Obviously, the investors, especially those from other EU countries, will pay even more attention to such issues, and this does not just apply to the industries that have, so far, been exposed the most to the regulatory risks (e-commerce, medical services, financial sector).

Experience in advising family businesses provokes the conclusion that such companies have a far lower need for legal compliance than, for example, transnational corporations or public companies. This results from the acquired conviction that if a given process and the related costs do not translate into profit in the short or long term, and the risk of loss is acceptable, it is not worth to engage in such a process, and in the case it is, minimum effort should be made.

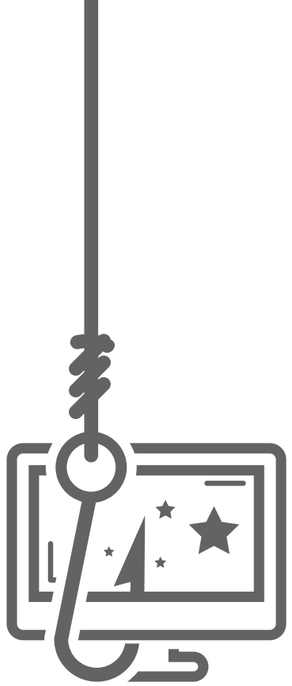


It is too late to make changes during the transaction negotiations

In the above-described context, the so-called vendor's *due diligence* gains real value and significance. It may be compared to a 'dress rehearsal' performed before admitting the potential investor's advisers to the company. The clash of different business philosophies, as well as of legal and organisational potentials, is a model example of a situation where this type of action is of profound significance. As a result of such an examination, the seller can learn how a prospective buyer would perceive their company.

In addition, knowing the key legal problems of the company being sold, one can better prepare for the sale, with the time aspect playing crucial part. For example, the implementation of some solutions, e.g. in the scope of RODO (GDPR), may sometimes require several months. Meanwhile, for medium-sized companies, usually only a few weeks pass between the conclusion of the letter of intent and the confidentiality agreement, and the end of the legal audit conducted the buyer. Immediately afterwards, reservations are formulated that may determine withdrawal from the transaction or a request to reduce the price to provide coverage for the detected risks. As one can easily deduce, when the investor turns up with a report from the legal audit, there is no possibility of implementing time-consuming changes. As a result, the seller bears the costs, makes efforts, and, additionally, bares their weaknesses to the potential investor, in vain.

It is, therefore, not surprising that business sale experts increasingly stress the fact that one needs to prepare for the transaction well in advance, lest it should end in failure. Ultimately, to put it from another angle, it is sometimes better to personally conclude that the company, while well-functioning, is unsellable, than to learn this from a third party. ■



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INTELLECTUAL PROPERTY: A CLOSER LOOK

As the modern economy grows, we witness a striking increase in the role of intellectual property and intangible services. It is difficult to imagine how any significant company would currently operate without conducting at least market analyses, licensing or advanced IT services.

In course of the development of modern corporations and mega-corporations, a number of such services is increasingly provided by specialized organisations from such entity, focusing on servicing the internal client, i.e. related entities. These changes have resulted in a turbulent development of the so-called shared service centers, which have become the driving force behind the development of many Polish cities.

Capital groups – a taxation perspective

From a taxation perspective the following common practice is key: purchasing a number of licenses and intangible services from related entities and using them in day-to-day operation, yet charging other entities in the group with the total cost of acquiring these services. Therefore, the key issue becomes being able to recognise such services purchased from affiliated entities as tax-deductible costs. The lack of such a possibility may put the further development of a number of specialized companies that provide services to related entities (including to some extent those operating in the shared service centers sector) in jeopardy.

For a long time, there have been numerous disputes between tax authorities and taxpayers regarding the tax consequences of using intangible services within capital groups. As a result the following practice has been set: the remuneration for such attribute (service) should always correspond to its market value. Thus, the subject of the dispute concentrated on two issues. Firstly, whether the services were actually performed and, secondly, how the market value of the payment should be determined.

For some time, however, tax authorities have been trying to question the legitimacy of paying fees for licenses and intangible services to related entities. Unfortunately, as evidenced by a substantial number of decisions, tax authorities claim that incurring such fees to a related party means that the connection between this cost and the company's revenues disappears. Of course, the question arises as to how the tax authorities reached such a conclusion. Does the mere fact of incurring fees to a related party nullifies the connection between the cost and the revenue? If an identical fee was paid to an outside party, would such a relationship exist?

For a long time, there have been numerous disputes between tax authorities and taxpayers regarding the tax consequences of using intangible services within capital groups. As a result the following practice has been set: the remuneration for such attribute (service) should always correspond to its market value.

At this point these are largely rhetorical questions. In recent weeks, voivodship administrative courts have repeatedly expressed their opinion on this subject and passed sentences in favour of the taxpayers. However, there is still no final resolution at the Supreme Administrative Court level..

Intellectual property and the amendment to the CIT and PIT laws

To make matters more interesting, at the beginning of the year, a comprehensive amendment to CIT and PIT entered into force, introducing significant restrictions on fees for use of intellectual property. At the moment, if such fees are paid to affiliated entities, only up to PLN 3 million may be included in the tax-deductible costs. If this amount is exceeded, the tax-deductible cost will be limited to 5% of the so-called EBITDA. They will... unless the company was already the owner of the licensing subject. Then the restriction goes even further and can effectively reduce the tax-deductible costs to zero.

Does it mean, therefore, that the legislator introduced a quasi-definition of the market value for license fees? Nothing of the sort. The market value issue is still valid. Taxpayers, however, are becoming increasingly uncertain, because today may find themselves in a situation where the remuneration may be deemed non-market (too low or too high), which can cause problems both on the part of the licensee and the licensor, and additionally the buyer has to monitor whether the market value did not exceed the tax-deductible cost limit. Because nothing prevents the market fee to be higher than the limits adopted by the legislator.

Advanced Price Agreement

However, there is a significant exception to the limits listed above – when the correctness of the price has been confirmed by obtaining the Advanced Price Agreement, APA. Although the procedure itself is tedious, time-consuming and expensive, it have very positive results for taxpayers. On the one hand, obtaining an advanced price agreement limits your chances of questioning the whether the amount paid indeed matched a market price, on the other hand it allows said fees to be included in the tax-deductible costs without any amount limits.

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Regardless of whether the simplification will be introduced, problems related to documenting provision of services, or to proving the connection between licenses and revenues, will remain. Therefore, we can conclude that either the taxpayers will be forced to pay the total costs of the amendment of the CIT and PIT Act (and continue to struggle with the problems of documenting the provision of services and the connection between the cost and revenues), hoping for a possible, albeit uncertain, introduction of a simplified APA. Or initiate the procedure to obtain APA right now and at the expense of tens of thousands of zlotys "buy" themselves the elimination of the new cost limits. As usual, you must make the decision yourself... ■

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