

2. combined assets (without elimination) of the parent and subsidiaries exceeding CZK 350 million, and/or
3. average number of employees in the last accounting period higher than 250.

The consolidation must be prepared using either the Czech Accounting Standards or the International Accounting Standards.

Joint-stock companies are required to have their financial statements and accounts audited if at least one out of following three conditions is met in the current or prior accounting period; other companies are required so if they meet two out of the following three conditions in the current or prior accounting period: (1) an annual turnover higher than CZK 80 million, total assets higher than CZK 40 million, or (3) average number of employees exceeding 50.

11. PRIVATISATION

Before the collapse of the centrally planned economic system in 1989, Czechoslovakia was one of the countries with the highest percentage of state owned assets (95 per cent). The transfer of state property to private hands has been achieved through a combination of direct disposals of state-owned enterprises to domestic and foreign buyers and through the innovative application of the voucher privatisation scheme.

Since 1989 the subsequent Czechoslovak and later Czech governments have been emphasizing that the pace of privatisation represents one of the most important criteria of the successful transformation from planned economy to the market system. Therefore, the speed of the transfer of property titles was given priority over the legal and institutional aspects of this profound change of property relations.

11.1. Voucher privatisation

Two waves of voucher privatisation were decided upon, transferring shares of approximately 60 per cent of state-owned companies to either individuals or investment funds in several rounds of bidding process. Every citizen over the age of 18 had a right to buy a book of vouchers for CZK 1000 which gave him/her a chance to bid directly for shares in companies which were being privatised.

In practice, however, the overwhelming majority of people were not familiar with the corporate landscape and financial instruments and institutions. Therefore, instead of investing their investment points directly to offered companies they entrusted their voucher books (each voucher book contained 1000 investment points) to investment privatisation funds in which they became shareholders. Thus, through the collection of investment points from the general public, these funds have concentrated a substantial amount of assets and holdings in the privatised companies and acquired a considerable economic power. However, the investment privatisation funds have been often linked to the large and still partially state-owned banks and these banks have been simultaneously lenders to the companies where their funds have controlling stakes. Due to the missing legislation (insufficient 'Chinese Walls' between the funds and their parent banks) the funds are to a certain extent 'originators and guarantors' of the commercial banking business for their parent banks in the companies where they have holdings. This situation naturally complicates a sound development of domestic capital market and it is not conducive to the much-needed growth of its liquidity.

Last updated February 2008

The voucher privatisation scheme thus brought about a change merely in the ownership structure of privatised companies but did not generate any new capital investment. The Prague Stock Exchange and the Czech capital market in general used to be perceived by the local investing public more as a mere mechanism for obtaining control of companies which were brought to the Exchange by the voucher privatisation, rather than as a vehicle for raising capital for further growth and development of listed firms. However, the perception has been changing. Successful initial public offerings on the Prague Stock Exchange as well as increasing interest from foreign investment professionals has led to big popularity of Prague Stock Exchange. In recent time, the Prague Stock Exchange and the Czech capital market generally are playing more important role for Czech and international investors and Czech companies.

11.2. Private buyers

Some of the state-owned enterprises were sold directly to previously identified foreign or domestic investors. Companies acquired by domestic buyers were often privatised through management buyouts (MBO) and because these transactions were funded almost exclusively by bank loans it was only natural that this method of privatisation led to a great number of firms being highly indebted and heavily under-capitalized. These firms are also currently forced to seek equity financing from both strategic and financial investors in order to strengthen their capital base. Some of the medium-sized and small companies, mainly from the manufacturing sector, with relatively high level of indebtedness, thus represent a natural target for potential overseas investors as well.

The remaining shares in companies that have not been fully privatised or shares in the strategic state-owned enterprises have been transferred to the National Property Fund (NPF), a state agency charged with legal and administrative issues of the transfer of state-owned assets to private buyers. The government thus maintains controlling interests in about 20 companies of strategic importance, such as the main electricity generator and distributor utility CEZ, the Czech railways etc.

The decision regarding the privatisation of these companies, as well as its timing and methods, are currently a subject of political discussions. Main issues raised in the debate deal with the problems which strategic companies should remain in the realm of public domain and in which form and to what extent, which companies should be privatised and offered through the public offerings or through trade sales to strategic investors, etc. The outcome of this debate very much depends on the balance of political forces in the country. There is, however, a general consensus prevailing across the political spectrum that the country needs foreign investment and that this investment should be supported.

11.3. Advantages and potential problems for investors

Advantages for international companies seeking investment opportunities in the Czech Republic could be summarized by the following:

- long and well-established industrial tradition, mainly in manufacturing industries;
- highly skilled and still relatively cheap labour force;
- stable macroeconomic environment in comparison with other former COMECON countries;

- no restrictions on foreign ownership and participation in joint ventures and Czech legal entities with the exception of the banking and defence sectors.

Main problems or potential risks for strategic investors may lie in the following areas:

- less transparent and still rather volatile legal and institutional environment;
- lack of expertise and experience in financial and marketing matters by the local senior management;
- insufficient depth and lack of liquidity of the domestic capital market.

12. INVESTMENT INCENTIVES

1. Tax relief on corporate tax for 5 years (newly established legal entities) or partial discount of corporate tax for 5 years (already existing legal entities)
2. Job-creation grants
3. Training grants
4. Provision of low-cost building land and/or infrastructure support
5. Transfer of real estate (agricultural land and other land) to the investor for an advantageous price

The incentive scheme distinguishes between (i) the manufacturing industry (i.e. production plants) and (ii) technology centres and business support services (i.e. technology and research centres, software development centres, high-tech repair centres, IT expert solution centres, shared services centres and callcentres), the rules for granting the investment incentives have enacted certain differences between these two groups of enterprises.

Above all, the incentives stated under numbers 1, 4 and 5 above apply to manufacturing industry only. The incentives stated under numbers 2 and 3 (job-creation grants and training grants) apply both to the manufacturing industry and technology centres and business support services.

12.1. Eligibility Criteria

- The investment must be made
 - (i) in the manufacturing industry into the construction of a new production plant or into the expansion or modernization of existing production facilities to launch a new production activity;
 - (ii) in the field of technology centres and business support services, into the construction of a new business site or into a significant expansion of existing business site provided that new technologies are implemented and new employees are hired.
- If the investment is made into the manufacturing industry, at least 60% of the investment must consist of machinery. The machinery has to be new and on a high technological level.
- In the manufacturing industry, the investor must invest at least CZK 100 million (approx. EUR 4 million) into fixed tangible and intangible assets. However, this limit is reduced in regions with

Last updated February 2008

high unemployment to CZK 50 million (approx. EUR 2 million), depending on the unemployment rate. At least 50% of the investment must be covered by the capital of the legal entity or by the equity of the natural person. The proposed production must meet all Czech environmental standards.

- In the field of technology centres and business support services, the investor must invest at least CZK 10 million (approx. EUR 400,000) and hire a certain number of new employees. The prescribed number of new employees depends on the nature of the particular enterprise (the more high-tech the enterprise is and the higher the required qualification of its employees is, the lower number of employees are required) and varies from 20 (software development centres, IT expert solution centres) to 100 (callcentres).
- Acquisition of the long-term tangible and intangible property to be financed by investment incentive is allowed from the day of submission of the application for investment incentive
- The investor has to fulfil the criteria described above within 3 years from the date when the incentives are granted. The investment and the newly created job positions (but not the concrete employees) must be met within 5 years from the date when the incentives are claimed for the first time. Non-fulfilment of these terms by the investor would be a breach of law and the state would have right to claim back the already paid incentives, including punitive interest and other monetary sanctions.

The Czech investment incentives scheme was from the outset designed as a scheme for both foreign and domestic investors under the same conditions. Originally, the headline tax incentive was available only for newly established legal entities without any prior business activities in the Czech Republic, but the new Act on Investment Incentives has introduced the tax incentive also for expansion projects.

Applicants for investment incentives are required to contact CzechInvest, the government agency charged with handling all applications for investment incentives. Upon receiving completed application and registration forms, CzechInvest will within 1 month evaluate the application and present its proposal on the granting of incentives to all other concerned government bodies via the Ministry of Industry and Trade. These bodies assess the proposal and issue their approval or disapproval. This procedure takes approx. 2 - 3 months. The Ministry of Industry and Trade will then, through CzechInvest, issue a binding offer of concrete investment incentives and their scope to the investor. Such offer is valid for 3 months. During this time the scope and value of incentives remain unchanged. Should the investor agree with the offer made, it must announce to CzechInvest its consent to the offer within the 3 month period in order to receive final confirmation of the offered incentives. The final decision is then issued by the Ministry of Industry and Trade within a period of max. 1 month.

The overall procedure usually takes from 4 to 8 months, the investor can significantly speed up the duration of the procedure by an active approach and well-prepared application.

The decision procedure on granting the incentives is not an administrative proceeding pursuant to the Administrative Procedure Code (500/2004 Coll.), therefore the investor has no legal claim for the incentives, the Ministry and other governmental bodies involved have wide powers of discretion for their decisions, and no legal remedy is possible if the investor's application for the incentives is refused.

12.2. CzechInvest

An autonomous agency set up by the Ministry of Industry and Trade in 1992, CzechInvest is charged with promoting and facilitating the inflow of direct investment to the Czech Republic.

12.2.1. Advice and handling of applications for investment incentives

CzechInvest is the sole body able to refer applications for investment incentives to the appropriate government bodies for approval. The agency closely co-operated on the preparation of the national investment incentives scheme and has in-depth knowledge of the scheme.

12.2.2. Location evaluation information

CzechInvest can provide data and various information about the current business and investment environment in the Czech Republic, brochures on several industrial sectors and information on the region of the Czech Republic

12.2.3. Aid with finding "greenfield" sites and production facilities

CzechInvest's extensive network of regional representatives maintains it with up to date information on available industrial real estate, both greenfield industrial plots and buildings. It maintains its own database of over 150 suitable sites or buildings around the country.

12.2.4. Assistance in finding local suppliers and joint-venture partners

CzechInvest has built an extensive database of Czech component suppliers. Profiles of these companies are available on a free access website at www.czechinvest.org.

12.2.5. Organisational aid and execution of visit programmes

Each project is assigned a project manager who stays with an investor throughout the lifetime of their project from first enquiry through to post-investment follow-up. A key role of project managers is to organise visits to potential sites and/or partners.

12.2.6. Assistance in dealing with bureaucracy at both national and local levels

CzechInvest's staff can provide help to foreign investors in dealing with bureaucracy at both national and local levels to ensure that rapid decisions are made.

13. MERGER CONTROL RULES

Owing to the rising number of restructurings of companies and the post-privatisation rationalization, the Czech Republic experiences increasing number of acquisitions and mergers.

According to the Commercial Code a merger is one of the ways whereby a company may be wound-up without liquidation. The Commercial Code allows even legal entities with different legal forms to merge. A merger is legally effective as soon as the merger is registered in the Commercial Registry. As of the date of the registration, the winding-up company(-ies) cease(s) to exist. An agreement on merger must be concluded before the merger can be legally effective. The agreement on merger must be approved by relevant bodies of all entities involved. The directors of all participating companies have to prepare a merger report, which should explain to shareholders/members/partners economic and legal reasons for the merger. Also the share exchange ratio and the amount of additional payment must be substantiated. All shareholders/members/partners of participating companies have right to familiarise themselves with the agreement on merger, the report of Boards of Directors and Supervisory Boards, expert's opinions and audited financial statements (for the previous three years) of the merging companies at least one month before the general meeting by which the merger is to be approved. However, in some cases shareholders/members/partners may agree not to prepare some of the abovementioned reports/documents. Also creditors must be notified in respect of their rights at least one month before the general meeting by which the merger should be approved.

Another way of acquiring a business is by a sale of an enterprise. The sale of an enterprise means that the seller assigns to the buyer the enterprise while the enterprise consists of things, other rights and other property values (assets) serving the operation of the enterprise. The buyer also assumes all obligations of the enterprise, including any undisclosed liabilities. The sale of enterprise requires similar procedure like a merger/de-merger of a company.

13.1. Public offerings

According to the Commercial Code, the public offers may be of two kinds: (1) the optional public offering and (2) the compulsory public offering. The rules regulating the optional public offering are less stringent than those regulating the compulsory one. For example the bidder can define the less or the highest amount of shares s/he is going to accept.

Companies are allowed to make public offerings to acquire shares of a target company from its shareholders. The offering must be valid for at least four weeks from its announcement, however the validity period must not exceed 10 weeks. The Czech National Bank as supervising entity can approve an even shorter period. No discrimination of the shareholders is allowed, i.e. they must be treated equally. The directors of the target company must be informed immediately by the bidder, once it decides to make the offering. The outcome of the offering should be then made public. The public offering is made public by the same way as an annual general meeting is summoned and must be announced in at least one daily paper distributed nationwide. Once a compulsory offering is made public, the bidder cannot withdraw nor make any changes to it unless these are in favour of potential acceptors. An optional offering may be changed or withdrawn only if this possibility is expressly stated therein and only due to serious reasons (interpretation of what is a "serious reason" would, in case of a dispute, be determined by court) and, unless such change is in favour of potential acceptors, only before the first notice of acceptance is received to the bidder. Withdrawal of or change to the offering must be published in the same manner as the offering itself. If the offering is changed in favour of potential acceptors after one or more notices of acceptance have been received, the more favourable conditions apply also to the acceptors who accepted the offering prior to such change.

Competitive offerings are allowed, provided that the offered price is at least 2% higher than the price in the original offering. If the target company's shares are registered, the Czech National Bank must be involved in the process.

When a shareholder reaches or exceeds the share on the voting rights attached to the shares of the company with its seat in the Czech Republic of which shares are traded on the Czech capital market or on the capital market of another EU member state at the rate of 3% (if the registered capital is higher than CZK 100,000,000), and 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50% or 75%, or if the shareholder decreases his share beyond these limits, s/he has to announce this fact to the company and to the Czech National Bank.

If an acquirer acquires a controlling interest, s/he is required to make a public offering for all outstanding shares within 60 days of the date from the date of acquisition or exceeding of the relevant percentage. The price in the compulsory public offering on publicly traded shares must adequately reflect the value of the shares. Weighted average of prices quoted on public markets for the preceding six months should be taken into account. The price must be supported by an expert opinion.

Business combinations are subject to the approval by the Anti-monopoly Office if:

- (a) the annual domestic net sales in the Czech Republic for the preceding financial year of all the merging companies were together at least CZK 1.5 billion (1500 mil.), with at least two of the merging companies having had annual net sales in the Czech Republic of not less than CZK 250 million each; or if
- (b) the annual worldwide net sales of at least one of the merging companies in the preceding financial year were greater than CZK 1.5 billion (1500 mil.) and the domestic net sales in the Czech Republic of one or more of the merging companies reached CZK 1.5 billion.

In some cases, e.g. banking and insurance sectors, corporate transactions are also subject to prior approval by the relevant regulatory body.

14. OTHER FORMS OF CORPORATE RESTRUCTURING

14.1. De-merger

De-merger of a company may, under the Czech law, take the following two forms: either dissolution with establishment of new companies or dissolution with a merger. Both cause the de-merged company to perish without liquidation while the assets and liabilities of the de-merged company are transferred to its legal successors and the shareholder(s) of the de-merged company become shareholder(s) of its legal successors. The dissolution with an establishment of the new company means that the de-merged company perishes and its assets and liabilities are transferred to two or more new companies. The dissolution with a merger implies that the de-merged company ceases to exist and its assets and liabilities are transferred to its successors, while at least one of the successors is not a new company but an existing one. The shares-swap ratio may be either proportional or disproportional. The proportional shares-swap ratio implies that each shareholder acquires the same proportion of shares in all legal successors and such proportion is equal to that as per the de-merged company. Alternatively, the shares-swap ratio is different in each of the successors – disproportional shares-swap ratio.

Last updated February 2008

14.2. Squeeze-out merger with perishing of a company

The purpose of the squeeze-out merger is to allow the perishing of a company without liquidation, if the majority shareholder is willing to accept all assets and liabilities of the target company. The squeeze-out mergers also should avoid chicaning from the minority shareholder(s).

The squeeze-out merger allows a company to perish without liquidation by transferring its assets and liabilities (employment related included) to a shareholder with his domicile in the Czech Republic. A majority shareholder in a joint stock company is entitled to buy out all minority shareholders while simultaneously merging with the joint stock company in such a way that the majority shareholder absorbs all of the joint stock company's assets. A court-sworn appraiser determines the amount of the payout.

14.3. Squeeze-out merger without perishing of a company

If shareholder owns 90% or more of company's shares or has 9/10 of votes at the General Meeting, such shareholder has the right, under certain conditions, to propose and perform buy out rest of the shares owned by minority shareholders on the price determined by expert.