Hostile Takeovers and Defence Tactics

2016

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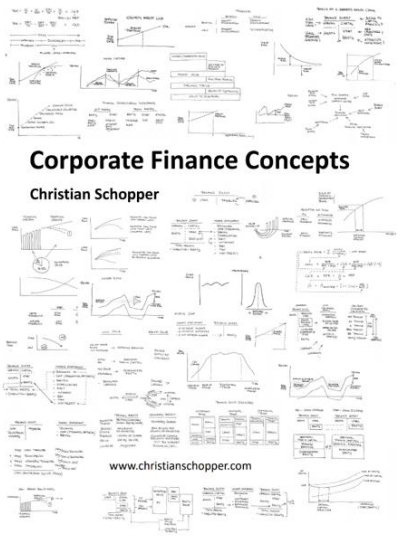

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Even „Friendly“ Mergers are Becoming Increasingly Hostile

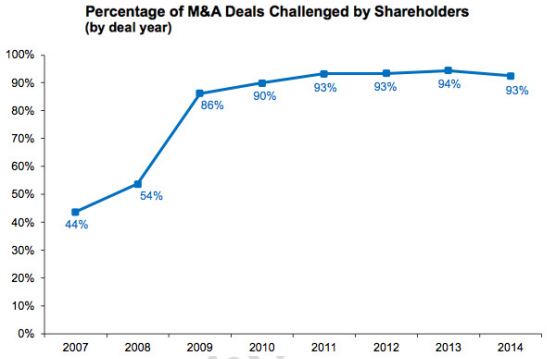
- Corporate mergers are often fraught with **uncertainty** over
  - Whether the deal will **succeed**
  - **Culture** clashes between the two companies and
  - The fate of **executives**

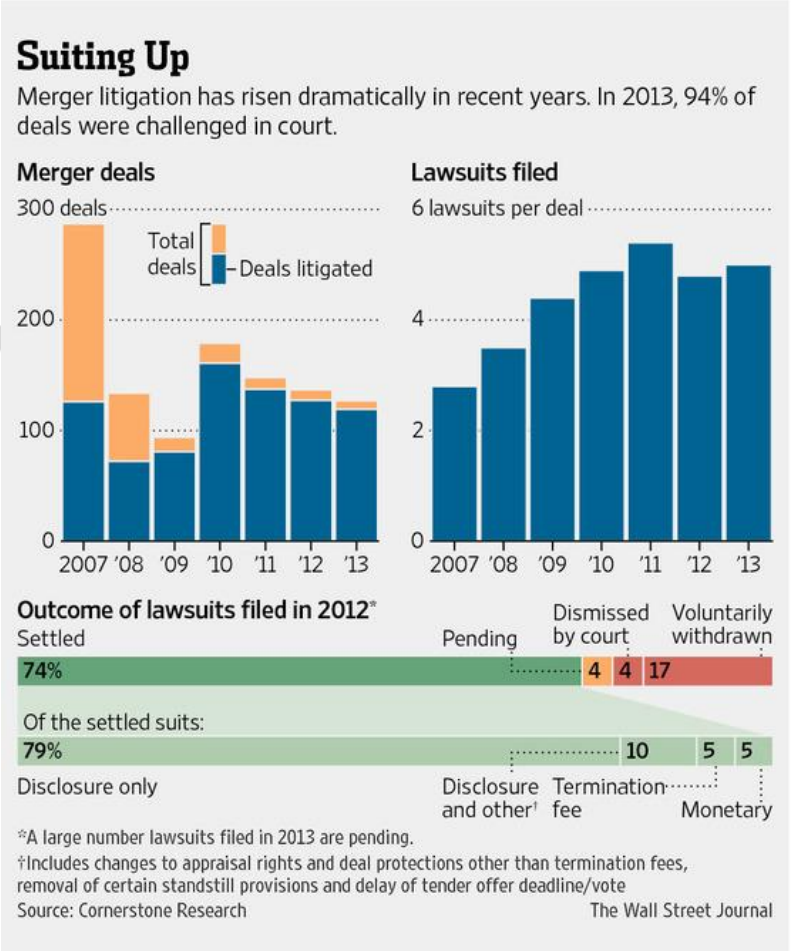
- But two things are virtual locks:
  - The companies will get sued by shareholders unhappy with some aspect of the deal, and
  - Eventually they will settle with the offended parties without significant changes to the transaction

- **Shareholders challenged 94% of U.S. public-company deals in 2013**, up from 44% in 2007, according to Cornerstone Research, a litigation consulting firm
  - The average deal now faces five lawsuits, often filed in different state and federal courts

- Lawsuits are among the weapons at shareholders' disposal to **hold boards accountable**
  - But the recent proliferation of legal actions has diluted their power, people on both sides of these cases say

Even „Friendly“ Mergers are Becoming Increasingly Hostile





Hostile Takeover

- The term “Hostile Takeover” is defined as when …
- … a company puts a bid on a target firm, …
- … which is being **opposed** by the **management** of the targeted company …
- … which furthermore advises its shareholders not to sell to the acquiring firm
- Also, if a bid is placed for the shares of the target company **without informing** its **board** and is directly aimed to the shareholders, the term hostile takeover is also applied
- A bid recognized as hostile is also called **unconsolidated bid**

Hostile Takover Tactics

- Limiting the target's actions through a "bear hug"
  - An offer made to buy shares for **a much higher per-share price** than what that company is worth
  - A bear hug offer is **usually made when there is doubt that the target company's management will be willing to sell**
- Proxy contests in support of a takeover
  - The acquirer will **persuade existing shareholders** to vote out company management so that the company will be easier to takeover
- Purchasing target stock in the open market
- Circumventing the target's board through a tender offer
- Litigation
- Using multiple tactics concurrently

Defense Strategies

- When facing a hostile takeover the board of directors will act
  - to **protect** their **independence** and current **management**, or
  - to ensure that the hostile bidder is pressured to **sweeten the bid** further

- Often, the main purpose of the chosen defense strategy is to **make the acquisition more costly or time consuming** and …

- … in such way **making the targeted company less attractive** due to the rise in cost which follows, together called: Defense strategies

- Defense strategies can be used **reactive**: Fend off a presented hostile bid - or …

- … be used **proactive**: Make sure to that future raids from targeting companies are slowed down or even hindered

Proactive Measures – Staggered Board

- A company seeking to take control over a targeted company is to try and get **representation on the targeted company's board**
- Companies with **staggered board** do not reelect all the board members annually, instead they only submit a group of members for reelection each year
  - This means that the entire group of **board members cannot be replaced on one annual meeting**
- Hence, staggered boards **prevent** the acquirer to gain **control** of the whole board **instantly**, cause substantial delays **associated with extra expenditures**, making the overall acquisition more difficult to finance
- Approximately 60% of U.S corporations and almost 50% of the S& P 500 firms list have adopted a staggered board
- In regards to valuation and take-over premia this defense strategy can be costly for the shareholders …

Proactive Measures – Poison Pills

- This strategy was first introduced 1982 by the New York layer Martin Lipton under the name "**warrant dividend plan**" …
  - … but was later changed to poison pill when he mentioned it in an article in the WSJ

- Poison pills have many names and therefore also described as, **shareholders rights**, **preferred shares**, **stock warrants** or **options**, which the target company offers and issues to its shareholders
  - In the U.S the board of directors can incorporate a poison pill without asking the shareholders, but in some countries this must be decided through a shareholders voting

- These **rights are inactive until** they are **triggered**, usually **when an unwanted shareholder acquires a pre-specified amount** of the outstanding stocks which has been agreed on by the board of directors
  - These pre-specified thresholds are often set in the range of 15-20% of the stock for a single shareholder who has not been in contact with the board of directors
  - If the company receives an offer for a large amount of its stock at one single occasion, a so called tender offer, then the threshold is higher and often around 30 per cent

Proactive Measures – Poison Pills (cont´d)

- The logic behind the pill is to **dilute the targeting company's stocks** in the company so much that bidder never manages to achieve an important part of the company without the consensus of the board and thus loses both time and money on their investment

- A ***flip-in pill*** *makes* it possible for the targeted company to issue **preferred shares** which only existing shareholders have the rights to buy
  - If they chose to exercise their rights then they will get the opportunity to buy additional shares in the company for a **price often far beneath the market value** of that share
  - These **rights can explicitly not be exercised by the acquiring firm or shareholder**, thus leading to the dilution of the bidders' shares because it cannot compete with shareholders who can buy them for a discounted price

- A ***flip-over pill*** issues **rights** rather than issuing preferred shares to existing shareholders. These rights are only triggered and set in motion when **100 per cent of the firms' shares have been bought**
  - The flip-over pill gives the existing shareholders in the targeted company the right to **buy the acquiring companies' shares for a discounted price in the event of a total merger or acquisition**
  - Using such rights is advantageous in defending a target because of its **negative impact on a balance sheet which comes from the raise in debt to the shareholders as an affect of the rights**
  - Increasing the debt means to raise the risk of the company's financial leverage and thus seen as very unattractive for the acquirer who has to inherit these debts

Proactive Measures – Super-Majority Amendment

- Typically, when it comes to making decisions regarding a merger, **approving takeover** or other large decisions in a company you **need a majority of the votes**, >50% of the votes, to approve the decision, meaning shares

- If a company implements a super-majority amendment in its corporate chart then this defense measure can **raise this specific percentage** needed to approve large majority decisions **to somewhere between 67% – 90%**
  - This amendment can only be placed in the companies chart by the shareholders and not by the board of directors, but it is the board who can decide to activate it.

- Also this defense measure does not alone stop a bidding company from buying and acquiring a large stock of the targeted company
  - As with the poison pill this measure makes it impossible for a bidder to immediately gaining control over the company and thus **making the deal costly and unattractive**
  - Instead the targeted company buys time to reflect over the bid and perhaps negotiate or pressure the bidder to present a higher premium offer

Proactive Measures – Golden Parachutes

- Golden Parachute as a defense strategy is a special and lucrative package, which aims to stagger and make hostile takeovers more expensive by distributing what is usually a **lump-sum payment to the board of directors** of the target company

- It may be argued, **though**, that receiving a large payment in the event of a job loss, the **managers will be less inclined to block any takeover attempts …**
  - … and therefore evaluating the best decision for the shareholders
  - Also, in general the cash payments as a cause of the golden parachute strategy are only small compared to what the whole acquirement as a whole would cost …

Proactive Measures – The Dutch Stichting

- AStichting is essentially an empty shell...
- … but can be equipped with special powers, such as veto rights over any unsolicited takeover bid

- Stichtings, which mean "foundations" in Dutch, have been around for hundreds of years, primarily used by Dutch charities
- During the World War II, Dutch companies transferred their ownership to stichtings based in the Dutch Antilles in the Caribbean to protect assets from the German occupiers, experts say

- Their key attribute is that stichtings, often referred to as orphan foundations, don't have any legal owners.
- "The stichting is where the buck stops …"

Reactive Defense Measures – Attack the Logic of the Bid

- By attacking the logic of the bid, the board is trying to persuade the shareholders that a fusion will have a **harmful outcome** on both the company and the stock price
- This is considered to be a cost beneficial tactic when facing a hostile bid
- Arguments used is often that:
  - The **bid is too low** and is not adequately representative to the real value of the firm
  - The two involved firms are **operating in different industries** and fusion will therefore have undesirable effect for the future
  - The acquiring company is **incompetent** and only trying to acquire the firm's assets. That action may not go as planned and maybe result in
  - Shareholders should **hold their shares for additional bids**
    - Frequently, Management devolves insider information to other potential bidders, to encourage them to enter the bidding contest thus increasing the probability of a higher bid

Reactive Defense Measures – White Knight & White Squire

- In the White Knight defense tactics, the targeted firm seeks for a **friendly firm** which can acquire a majority stake in the company
  - With a white knight the management of the targeted company can negotiate several deal constellations that do not have to include a full takeover of the firm and risk losing their positions

- A white knight can be chosen for several **reasons** such as
  - Friendly intentions,,
  - Belief of better fit,
  - Belief of better synergies,
  - Belief of not dismissing employees or
  - Historical good relationships

- The most common outcome of a white knight strategy would be that the targeted firm eventually gets overtaken by the white knight
  - This implies that it is not always certain that the targeted company will remain independent but instead slips away from a hostile bidder which would suggest greater restructuring of the firm.

- The ***White Squire***, instead, acquires a **smaller portion**, but **enough to hinder the hostile bidder from acquiring a majority stake** and thereby fending off an attack
  - Here are hedge funds and banks suitable white squires due to their ability to move large amount of capital on short notice

Reactive Defense Measures – Greenmail

- If the bidders' interests are short-termed profit rather than long-termed corporate control then Greenmail is an effective and simple defense measure

- Greenmail involves **repurchasing a block of shares** which is **held by a single shareholder** or other shareholders **at a premium over the stock price** in return **for** an agreement called **a standstill agreement**
  - In this standstill agreement it is stated that the bidder will no longer be able to buy more shares for a period of time, often longer than five years

- Usually, however, greenmail is **only proven effective towards short-termed profits seeking bidders**, but not against bidders who is seeking long-termed synergy effects and control in the company

- In the U.S. since 1986 the use of greenmail has drastically declined due to **tax regulations** which indices a 25% penalty on the company making the greenmail payment and therefore making it to a very expensive measure

Reactive Defense Measures – Crown Jewel

- By implementing a Crown Jewel defense, the target company has the right to **sell** of the entire or some of the company's **most valuable assets** (Crown Jewels) when facing a hostile bid, in hope to **make the company less attractive** in the eyes of the acquiring company and to force a drawback of the bid

- A **variation** of the crown jewel defense is for the target company to **sell its Crown Jewels to another friendly company** (White Knight) and **later** on **buy back** the assets sold to the White Knight at a fixed price agreed in advance

- A **complication** in adopting the Crown Jewel defense strategy has to do with the amount of **cash** or liquidation the target company is able to **receive** from a third party
  - If it turns out that the target firm received a lot of money for its assets, it **could potentially make the company even more attractive** to the acquirer, a result completely opposite the aims of the Crown Jewel defense strategy

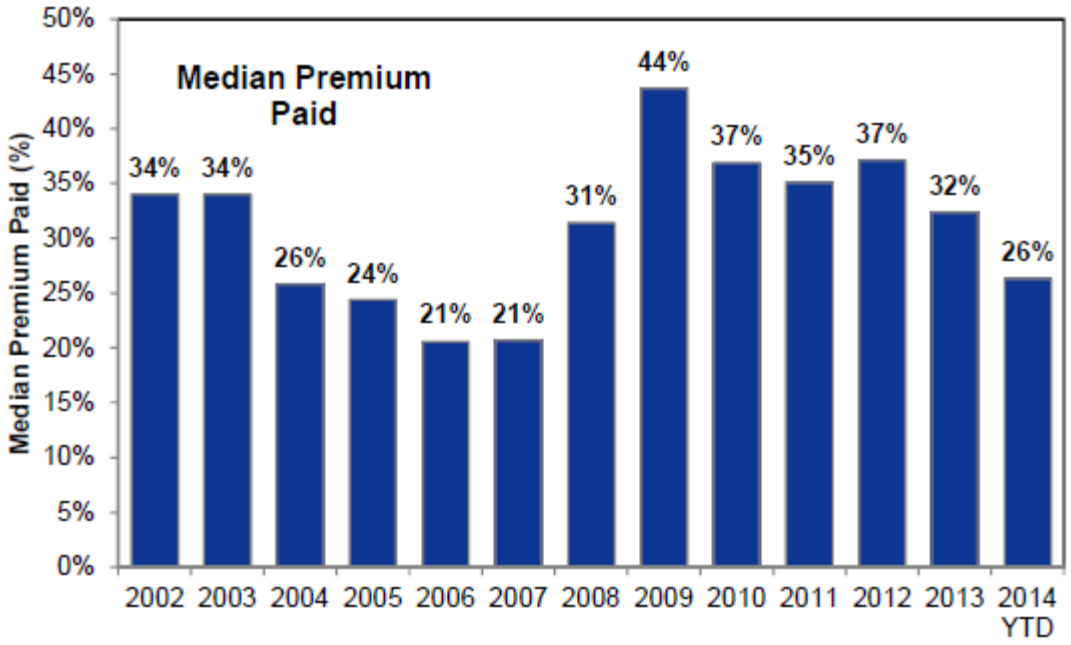
Reactive Defense Measures – Litigation

- Litigations are ways for companies to stall a hostile attack, but are often not effective against long-term bidders
- The litigations often involve pursuing **legal injunction**, **filing antitrust litigations**, restraining orders or **filing** a **law suit** against the bidding company
- This pressures the bidder to gather information to prove its legitimacy of the takeover
- During the time the bidder is preparing and presenting its legal preferences, the targeted company receives a space to implement other defense measures or to pressure the bidder to sweeten the bid additionally in exchange drop the litigations

Appendix

Control Premia

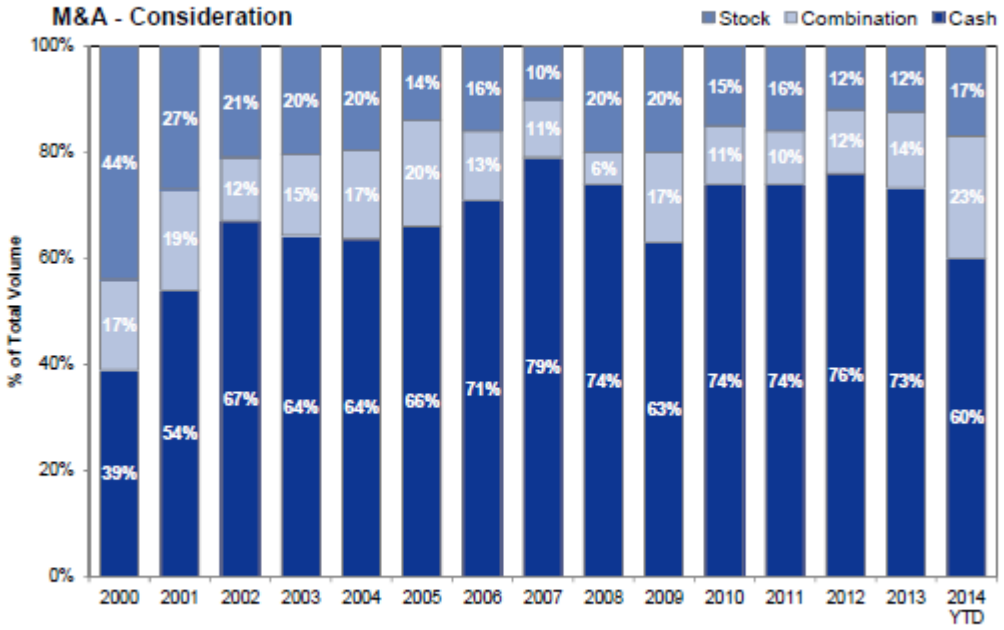
Exhibit 3: Median premium paid on US announced M&A transactions
as of June 2014



Source: FactSet Mergerstat and Goldman Sachs Global Investment Research.

M&A Consideration

Exhibit 4: Consideration paid in stock, cash, and a combination
as of June 13, 2014



Source: Thomson Reuters / SDC and Goldman Sachs Global Investment Research.

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