

HOSTILE TAKEOVER BIDS IN AUSTRALIA IN 2017 (PART I) - THE YEAR IN REVIEW

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Legal Briefings - By **Rodd Levy and Sam Kings**

Hostile takeover bids are a significant part of public company M&A activity in Australia. We examine the key defence tactics and themes we observed in 2017.

IN BRIEF

- Nearly a third of all public company M&A deals announced in Australia in 2017 were hostile takeover bids.
- Given hostile bids are a significant part of our market (even if they represent a comparatively small amount of total deal values), public company directors should have an understanding of the key defence tactics that target directors have used recently to generate extra value for shareholders.

HOSTILE TAKEOVER BIDS IN 2017 - BY THE NUMBERS

In value terms, hostile takeover bids¹ were only a small part of public company M&A activity in Australia in 2017. This is consistent with recent years.

However, by sheer number of transactions, hostile bids are a significant part of our market. In recent years, hostile bids have comprised between 25-35% of all public company transactions (including all takeover bids and schemes of arrangement). In 2017, 32% of all transactions announced were hostile bids (20 out of a total of 62).

The aggregate market capitalisation of target companies involved in hostile bids in 2017 was in excess of A\$2.8 billion. This is greater than in 2016 (A\$1.6 billion), but slightly lower than in 2015 (A\$3.0 billion).

Whilst most of the hostile bids in 2017 were small, some of the larger hostile bids in the last 12 months include:

- Downer's A\$1.2 billion bid for Spotless;
- NWH's A\$520 million bid for Generation Healthcare REIT;
- CERCG's / Mineral Resources' / Mitsui's bids for AWE;
- Capitol Health's A\$347 million bid for Integral Diagnostics;
- Eastern Field's A\$177 million bid for Finders Resources; and
- CIMIC's A\$174 million bid for Macmahon.

Most of the large transactions in our market are effected by a recommended scheme of arrangement due to the general reluctance of bidders to launch bids without due diligence, or confidence that the bid will be supported by target directors.

A scheme proposal gives target directors time to consider their response and agree a path forward with the bidder. There is much more pressure on target directors in a hostile scenario – directors need to really understand the value of their company, assess the merits of the bid and how to best maximise shareholder interests (all of which must usually be done in the public spotlight and under the bidder's scrutiny).

ANALYSIS OF KEY DEFENCE TACTICS USED

DIRECTORS' RECOMMENDATION CRITICAL TO SUCCESS

In 2017, with only 1 exception:²

- no takeover bid was successful unless at some stage during the bid it was recommended by the target board; and
- all bids that directors recommended shareholders reject were unsuccessful.

In every case where a hostile takeover was eventually recommended, the bid was successful.

The market experience shows that, even if the bidder has a significant pre-bid stake, this will not diminish the importance of the board's recommendation:

- 12 of the 20 hostile situations involved bidders with a pre-bid stake of more than 10% (with 5 of those bidders having more than 20%) only 1 was successful; and
- 5 of these bidders increased their initial offer price (presumably to win a recommendation), but, despite this, only 1 bidder³ was successful without target board support.⁴

USING THE DIRECTORS' RECOMMENDATION TO NEGOTIATE INCREASES

Given how important a recommendation is for a bid to be successful, it is common for directors to seek to trade a recommendation for an increase in the bid price.

In 2017, 5 bidders increased their initial offer price. There were 2 instances where this led to target directors recommending that shareholders accept the deal, though the amounts involved were not significant:

- whilst the Aurora Property / Reckson New York Property Trust deal was relatively small in dollar terms (A\$4.5 million), in percentage terms, the increase gave shareholders another 11% above the initial bid price; and
- the increase in the NorthWest Healthcare Properties Real Estate Investment Trust / Generation Healthcare REIT transaction meant shareholders received approximately 3% more than they would have under the original offer.

These were also the only instances where the increase was not the result of a rival bidder emerging.

Despite this, we consider that, generally speaking, a recommendation can and should be used at appropriate times to negotiate an increase in the offer price for the benefit of all shareholders.

INDEPENDENT EXPERT'S REPORTS A VALUABLE TOOL FOR TARGET DIRECTORS

An independent expert was engaged, or the target said it would engage an expert, in 13 of the 20 hostile takeover bids announced in 2017. The directors in 6 instances did not commission a report.⁵

In 82% of the reports available at the date of this article, the expert concluded the offer was 'neither fair nor reasonable'. The target board recommended that shareholders reject the bid in each case.

The independent expert's opinion preceded a price increase in 4 instances⁶ that, on average, boosted the initial bid price by 17%, plus led to a rival bidder emerging in one of those instances.⁷ So, at least in those instances, the expert's report helped deliver significant value to shareholders.

There were 2 bids that the expert concluded were 'fair and reasonable'. Both bids were recommended and the bidders were successful.

STRENGTH IN NUMBERS - THE POWER OF SHAREHOLDER INTENTION STATEMENTS

There were 5 takeovers where the target directors managed to get shareholders to make public statements that they intended to reject the bid. These statements are regarded as binding on the shareholders under the 'truth in takeovers' principle.

In each case (excluding 2 which are ongoing), the bids failed. Of those failed bids, on average, the rejection statements were from holders of 32% of shares.

COMMENTARY

Analysis of the hostile bids in 2017 shows that there are a number of things target directors can do to generate value for shareholders in a takeover situation.

This includes:

- being selective with the use and timing of their recommendation (i.e. in appropriate cases, using the recommendation as a bargaining tool for an increased bid);
- using an independent expert's report as a defence tool (i.e. to show that the offer undervalues the company, if indeed that is the expert's opinion);
- canvassing major shareholders and announcing shareholder intention statements if there is support for the board's position; and
- pro-actively soliciting and facilitating rival bids and considering alternative transactions (see [Hostile takeover bids in Australia in 2017 \[Part II\]](#) for more detail).

If target directors do these things – plus have a defence plan that can be quickly implemented if a hostile bid is made and can easily explain the value of the company to shareholders, an independent expert and the market generally – then they will be well placed to create maximum value for their shareholders.

ENDNOTES

1. For this purpose, we treated as ‘hostile’ any bid that was not supported by a recommendation of the target’s board of directors from the outset. In other words, any public takeover bid which was announced and unsolicited.
2. The exception was Geopacific Resources’ A\$8.5 million hostile bid for Kula Gold.
3. Geopacific Resources.
4. One bid is still ongoing.
5. In one current bid, the directors have not publicly stated whether they will engage an expert.
6. Mercantile OFM / Bauxite Resources, Firstmac Holdings / Goldfields Money, Pinnacle Ethical Investment Holdings / Hunter Hall International and Geopacific Resources / Kula Gold.
7. Pinnacle Ethical Investment Holdings / Hunter Hall International.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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