INTECQ SITUATION HIGHLIGHTS DELICATE GATEKEEPER ROLE FOR TARGET BOARDS

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Legal Briefings – By **Rodd Levy** and **Kam Jamshidi**

Intecq decided not to disclose both the initial approach made by WIN Systems in December and the subsequent decision not to engage with the bidder.

- Media leaks in late March 2016 regarding WIN Systems' approach 4 months earlier was a trigger for the obligation to announce Intecq's decision not to engage.
- In formulating the disclosure strategy following an approach, target boards must delicately balance views on fundamental value, likely shareholder views, transaction negotiation strategy and ramifications of a subsequent leak.
- The ASX's view is that if a proposal is rejected, it is not necessarily disclosable. However, some targets have decided to disclose such rejections.
- A well thought out disclosure strategy can be critical to the broader transaction negotiation strategy in public deals.

Intecq Limited's treatment of the unsolicited proposal from Spanish firm WIN Systems highlights the flexibility available to boards in dealing with the announcement of approaches from a potential bidder, provided such dealings remain incomplete and confidential.

The Intecq situation is a reminder of the important gatekeeper role target boards play in dealing with indicative, non-binding proposals. Controlling engagement with the bidder and the communication with the market can bear heavily on the bargaining power in dealing with such proposals, as well as volatility in the target's share price and disruption to the target's business. Therefore careful judgment by the target board must be exercised to formulate the optimal negotiation and disclosure strategy in public transactions.

INTECQ SITUATION

The Australian newspaper reported in late March 2016 that Intecq had received an approach in December 2015 from a strategic buyer. The report speculated that the bidder was Spain's WIN Systems that had proposed an indicative offer price at a 30% premium to

- Intecq's share price. Intecq responded to the media speculation by immediately releasing a short announcement confirming that:
- Intecq had received an approach,
- the board had decided not to engage with the bidder,
- the proposal was highly conditional, and
- the proposal did not reflect the board's view on fundamental value.

Interestingly, Intecq did not disclose the bidder or the proposed offer price.

The Intecq board's decision not to announce both the approach and the decision not to engage with the bidder highlights the delicate balancing act for target boards.

On the one hand, boards will want to be transparent with shareholders, and the risk of subsequent loss of confidentiality where an approach is rejected can weaken perceptions of the board and cause shareholder discontent.

On the other hand, engagement strategy with a bidder, including the granting of due diligence, is a critical bargaining chip for boards that should not be traded cheaply and is usually best negotiated in private. The ASX's guidance note 8 acknowledges this and reflects the desire to give target boards flexibility to deal with confidential and incomplete proposals in a manner that best deals with the circumstances.

LEAKED DEALS CAN BE VERY DISRUPTIVE FOR TARGETS AND THEIR SHAREHOLDERS

Once confidentiality of an approach is lost, an announcement by the target will be necessary – the ASX guidance and market practice is clear on this. Such disclosures can, nevertheless, create share price volatility and distract target boards from the core considerations of forming a view on fundamental value and achieving deal certainty.

A good example of the shareholder uncertainty and disruption that can be caused by forced early disclosure is the Western Union approach of OzForex during December 2015.

In late November 2015, OzForex was forced to announce it had received an indicative proposal from Western Union following media speculation regarding the potential approach. OzForex granted exclusive due diligence to Western Union soon after the announcement and, while due diligence lasted for close to three months, Western Union ultimately declined to proceed with an offer. The disclosures created significant volatility in the OzForex share price, with OzForex's share prices rising 30% on the day the approach was announced, but then falling more than 40% on the day OzForex announced it had ended discussions.

As at the time this article was written, Intecq's share price was more than 15% higher than three weeks earlier when media speculation regarding the WIN Systems approach first came to light. Interestingly, this is approximately 30% above the Intecq share price on the date the proposal was received from WIN Systems, which is the level at which newspaper reports have suggested the indicative offer was set. The share price movement suggests that at least some shareholders have built in assumptions regarding the likelihood of a deal being completed, notwithstanding the announcement made by Intecq clarifying that it had rejected the approach made.

Importantly for targets, the share price volatility is in addition to the considerable management resources and costs expended to deal with the bidder. Where this engagement is public, the business can suffer significant additional disruption caused by the uncertainty of future ownership, such as customers or suppliers hesitating to engage with the target or employees becoming distracted by future employment considerations.

DISCLOSURE OF A REJECTED PROPOSAL

Once a proposal is rejected, some target boards have taken the view that disclosure of the rejected proposal is important in the interests of transparency with shareholders and to reduce the risk of the target board being criticised on its engagement strategy should the approach subsequently come to light.

Interestingly, ASX guidance note 8 takes the view that if a target receives a confidential proposal that is rejected by the board, it is not necessarily disclosable. Notwithstanding this position, some targets have elected to disclose the rejection of an approach. For example, this was the course of action employed in 2015 by the Santos board, upon rejecting the Scepter Partners indicative proposal, and ALE Property Group's board, upon rejecting Caledonia's approach.

In the Intecq matter, the board took the alternative approach of not disclosing the rejection of the approach. There can be good reason for adopting this strategy. For example, negotiations with bidders are often multi-staged, with the first approach not always being the bidder's final position. Indeed this is an important purpose served by the safe harbour under the continuous disclosure rules for incomplete proposal and negotiations, to allow corporate proposals to be developed and negotiated into something the target believes can be put to shareholders without public influence. The Intecq board may have considered it in the best interests of shareholders not to announce the rejection of the proposal on the possibility that WIN Systems may return with a superior proposal.

A further element is how third parties will potentially influence or impact the transaction negotiations should the approach become public. The pressure mounted by the media and a group of target shareholders in the PEP acquisition of Spotless in 2011 is a good example of where third parties, some of whom's interests should seemingly be closely aligned with the board, can disrupt a target board's negotiation tactics with a bidder.

These considerations highlight how the disclosure strategy becomes closely intertwined with the negotiation strategy adopted by target boards. The correct approach to adopt on this strategy is an assessment to be made on the merits in each case.

CONCLUSIONS

The flexibility afforded to target boards under the rules dealing with incomplete but confidential proposals is a reflection of the need to develop a customised disclosure strategy within the circumstances and how that relates to the broader transaction strategy.

For target boards, such strategy will need to be developed on a case-by-case basis. However, what is consistent is that managing confidentiality will always be critical factor in allowing targets to control the engagement process and has the potential to cause significant share price volatility and business disruption.

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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