HERBERT SMITH FREEHILLS

TAKEOVER DEFENCE: RECENT TRENDS, THEMES AND TACTICS

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Legal Briefings – By **Rodd Levy**

In this article, we discuss some key aspects of public company M&A activity over the last 12 months and examine the effectiveness of measures taken by target company directors in response to acquisition proposals.

IN BRIEF
• Target boards continue to play a vital role in protecting shareholder interests in takeover situations.
• Risks and complexity of public company transactions must be managed to preserve company value, particularly as transactions are taking longer to become effective.
• ESG issues are driving M&A behaviour.

GENERAL OVERVIEW OF THE MARKET

Global M&A activity levels for 2019 were more or less in line with recent years. Even though the US$3.33 trillion value of transactions globally in 2019 was down 6.9% on 2018, influenced by weaker activity in Europe and the Asia Pacific, it was essentially consistent with the previous five years.[1] One obvious point is that Chinese acquirers are far less active than they were a few years ago. This has affected deal flows around the world, but has been off-set in global terms by an increase in domestic US mergers.

Australia's M&A market continues to be active. The results for our market are sometimes influenced by one or two large transactions. 2019 was no exception. There were 607 M&A transactions worth A$87.4 billion recorded in 2019. That strikes us as a very healthy market, but Mergermarket reports that it represented the lowest aggregate deal value since 2013. The largest deal was Asahi's private acquisition of CUB from InBev for A$16.9 billion.
HSF was ranked 1st by Mergermarket for Australian law firms, measured by the number of transactions in our market in 2019.

GENERAL THEMES IN THE AUSTRALIAN M&A MARKET

Using 2020 hindsight, we observed the following themes in Australian public M&A in 2019:

- target boards continue to play a critical role in protecting shareholders' interests in a takeover scenario. As acquirer strategies become more sophisticated, boards who have been tactical have managed to maximise outcomes for shareholders;

- transactions, particularly larger transactions, are being played out over longer timeframes and complexity has increased. This feeds into risks for the company while the transaction is ongoing and affects the allocation of risk associated with the transaction (eg the longer the transaction takes, the more likely it is that the company's business may be adversely affected);

- there has been an increase in the importance of environmental, social and governance (ESG) factors in M&A decision-making. We have seen various transactions undertaken by companies seeking to re-balance their operations and portfolios to preserve corporate reputation and satisfy investor and customer demands. Some obvious local examples from recent years include the sale of coal assets by a number of large corporates and exits from poker machines businesses;

- Australian institutional investors (including the continued prominence of large super funds) have become more active in participating in public market control transactions. This includes examples where they have been bidders or part of a bidding consortium (eg QIC and AustralianSuper) and where they have increased stakes after a transaction has been announced and then agitated for improved terms; and

- deal technology continues to evolve to balance bidder certainty with the desire to facilitate an auction. In the last 12 months, successful strategies have included the use of a concurrent bid and scheme to overcome a blocking stake (eg Healthscope), the use of 'go-shop' clauses (eg MYOB) and increasing use of process deeds.

In addition, we continue to see a rise in regulator intervention (a theme we have observed both globally and locally for a number of years). ASIC has played a large role in many transactions and transaction structures have been changed to accommodate ASIC's views. The ACCC remains active. A prime example is the ACCC seeking to block the $15 billion merger between Vodafone Hutchison Australia and TPG Telecom on competition grounds. HSF acted for TPG in successfully persuading the Federal Court that the merger would not substantially lessen competition.

Each of these themes underscore that the Australian public M&A landscape is becoming increasingly complex to navigate.

TAKEOVERS PANEL SUPPORT FOR TARGET BOARDS

The Takeovers Panel confirmed in its *Pacific Energy* decision in late 2019 that it will not second-guess decisions made by a target board in running a transaction process.

In that matter, Pacific Energy entered into a scheme implementation deed (**SID**) with QIC under which QIC would acquire Pacific Energy for $0.975 per share. Under the SID, a $4.1m break fee would become payable by Pacific Energy in certain circumstances.

Subsequently, Pacific Energy received a rival proposal from a consortium at an 11% premium to QIC's agreed price. To advance the rival proposal, Pacific Energy entered into a process deed with the consortium under which a break fee would be payable by Pacific Energy if it did not execute a SID with the consortium by a certain date. QIC considered that this was in breach of its SID with Pacific Energy. QIC exercised its matching rights and made an application to the Takeovers Panel before Pacific Energy accepted QIC's revised offer. This triggered the break fee payable by Pacific Energy under the process deed with the consortium.

The Takeovers Panel took a pragmatic approach and decided not to conduct proceedings. This was despite the allegation that Pacific Energy had wilfully breached the SID by entering into the process deed with the rival consortium.

The Takeovers Panel accepted that the process ran by Pacific Energy was unusual, but it placed great weight on the fact that Pacific Energy achieved an 11% premium for its shareholders and Pacific Energy complied with the substance of QIC's matching rights (QIC was able to submit a revised proposal which was accepted by Pacific Energy). The fact that Pacific Energy had to pay the consortium a break fee for proceeding with QIC's revised offer did not undermine the board's approach because it was necessary in order to secure the 11% premium.

This should give comfort to boards seeking to discharge their duties in takeover situations.

HOSTILE TAKEOVER BIDS IN 2019

Hostile takeover bids are a significant part of public company M&A in Australia. While the takeover heydays of the 1980s and 1990s are over (replaced largely by friendly schemes of arrangement), hostile bids still typically comprise between 25-35% of all public company transactions in Australia (including all takeover bids and schemes of arrangement). In 2019, 27% of all transactions announced were hostile bids.[2]

Even though the conclusions in this article are based on a relatively small sample size, they are consistent with our experience. Here are two key lessons from defence tactics used in 2019.

HOSTILE TAKEOVER BIDS WERE NOT SUCCESSFUL WITHOUT A RECOMMENDATION FROM TARGET DIRECTORS

The strongest tool in a target board's arsenal when faced with a hostile takeover bid is the ability to withhold its recommendation. In 2019, there were four instances where target boards had recommended that shareholders reject the offers. One of those transactions is ongoing, but, of the 3 hostile takeovers which have concluded, none have been successful.

Conversely, all successful takeover bids in 2019 were supported by the recommendation of the target's board. There were 7 in this category.

Often the board can use its ability to recommend to negotiate for a higher offer price. In six instances in 2019, the target board eventually recommended that shareholders accept the bid. However, in all but one instance, the target boards did not do so in exchange for an increase in the bid price. This is unusual in our experience. This can be explained by a couple of factors:

- the independent expert in those transactions opined that the takeover bids were fair and reasonable, limiting the negotiating position of the directors; and
- the bidders held significant stakes in the relevant target companies when the bids were first announced to the market. This ranged from 9% to 96.5%. The risk of becoming a minority shareholder in a listed company would have been a powerful incentive to accept.

THE POWER OF AN INDEPENDENT EXPERT'S REPORT

An independent expert was engaged by target boards in 10 of the 16 bids.[3] At the date of this article, 9 expert reports had been released to the market.

In 8 reports, the expert opined that the offer was 'fair and reasonable'. In each instance, the target board recommended that shareholders accept the offer.

In the remaining example, the expert opined that the transaction was 'not fair but reasonable'. However, the target board recommended that shareholders accept the transaction, which was eventually successful. The recommendation and expert's report came after the bidder improved its offer price by ~29%.

CONCLUSION

Our analysis shows that target board strategy is still a powerful determinant of the outcome of transactions.

ENDNOTES

1. All figures in this letter are from Mergermarket. There were 19,322 M&A transactions globally in 2019.

2. For this purpose, we treat 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 is announced and unsolicited.

3. In one instance the bid was withdrawn before a target’s statement was issued, so it has been excluded from this number.

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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