

Takeovers

By Michael Kemp

There's something innate in the makeup of most CEO's - as if it's embedded deep within their DNA - they want the company they head to keep getting bigger.

Author and investment great, Ben Graham, termed this characteristic aggrandizement. It's an effort to extend one's power, influence and reputation; to build an empire. Sometimes the empire they build is strong but sometimes it's built on sand.

The main vehicle used to facilitate this aggrandizement is the corporate takeover. The fuel of takeovers is bank-supplied credit and shareholder-supplied equity. But beneath all this corporate activity there's something that you, as a shareholder, need to realize. It might be the CEO who is playing the game but it's the shareholders who are placing the chips on the table.

This article takes a look at the takeover process. It considers what you should do when a takeover looms and, most importantly, it considers when the takeover is in your best interests or when it's simply a CEO's folly.

What is a takeover?

In common usage "Takeover" means the acquisition of control of a publicly listed company. I don't want to enter into a lengthy discussion about the precise meaning of "control" but typically it describes when a bidder acquires either all or a majority of the voting shares in the target company, with the target then becoming a subsidiary of the acquirer.

How a takeover works

Takeovers can be friendly or hostile and are typically undertaken via a takeover bid or a scheme of arrangement.

Let's take a look at the differences between them.

Takeover Bid – this is where individual offers (to each shareholder) are made in order to purchase the target securities at a specified price. Takeover bids can be friendly (where the acquired is happy to be taken over) or hostile (where the target usually resists). A takeover bid can be made off-market (not using the share market) or via a market bid (using the share market). Most takeover bids are made off-market because this allows conditions to be included in the offer.

When a takeover bid is made shareholders of the target company will receive a written offer to buy their shares, which they can either accept or reject.

Scheme of arrangement – this is where all shareholders vote on the offer first and their shares are acquired only if the resolution is passed. Therefore schemes of arrangement are used only for friendly acquisitions and are often used where 100% of the target is being acquired.

All shareholders in a scheme of arrangement must singularly abide by the vote since it ultimately becomes a court-approved statutory arrangement and is therefore binding by law.

Regulatory requirements

Takeovers in Australia are regulated by a combination of legislation, government policy and stock exchange rules. The main takeover rules are spelt out in the Corporations Act and are administered by ASIC. If a dispute arises it is managed by the Takeovers Panel. There are many rules covering takeovers but since I don't want this article to read like a legal textbook I'll simply cover one of the main ones - the 20% rule.

The 20% rule states that a person cannot acquire more than 20% of a company (the 20% threshold) except via a specified exception. A specified exception includes takeover bids and schemes of arrangement. So when the threshold is hit the takeover machinery is triggered.

Response to a hostile takeover

When an off-market bid is launched in relation to shares that you own you will receive letters from both sides of the battle. The first, describing the details of the offer, will be from the bidder. The second will be from the directors of your company. Your directors are obligated to respond to the bid by issuing a target's statement.

The statement from your company's directors will usually advise you that the offer significantly undervalues your shares and that that you should reject it. This will be backed by an "independent valuation" undertaken by a financial house acting on behalf of your company. Of course company valuations are pretty rubbery beasts at the best of times so the "independent valuation" can be any figure the appointed advisor wants it to be. And a financial house employed to defend against a hostile takeover is unlikely to conclude that the initial offer is a fair one!

Cynicism aside the directors, in rejecting the initial offer, are usually acting in the best interests of the shareholders. That is, by rejecting the initial offer, they are seeking a higher bid(s) from the initial bidder or new offers from an alternative bidder(s).

That said sometimes management's judgment regarding the adequacy of the initial offer can be clouded since, price aside, they are usually defending both their jobs and their pride.

What should you be doing?

Read the documents.

Once a takeover bid is announced the bidder must make an offer to buy your shares within 2 months. Having received the offer, don't act immediately. You should wait until you have also read the target's statement before you consider responding to the bidder's offer.

For schemes of arrangement you will receive a scheme booklet from the company you own shares in. Because of additional requirements involved with schemes receipt of the booklet could take a few months following its announcement. The scheme of arrangement booklet will describe the nature of the arrangement and typically include an independent expert's report outlining whether or

not the offer is fair and reasonable and in your best interests. Because this is a vehicle reserved for friendly acquisitions you are likely to be told by your directors that it is fair and reasonable. You can vote on the arrangement either in person at the scheme meeting or send in your proxy form.

Look out for ASX announcements and monitor the financial press

Following the announcement of a takeover bid or scheme the situation can change quickly. The price offered may increase, or the period for accepting the takeover bid may be extended. So you should watch the media for updates.

You should also visit the ASX website regularly to see if any announcements have been made. Sometimes information will be found in ASX announcements rather than sent to you directly.

Determine value and keep an eye on the share price

Whether a takeover or scheme of arrangement makes sense is usually a value versus price decision so determine for yourself whether the prices being thrown around seem fair. This applies whether your own shares in the acquirer or the to-be-acquired. The corporate graveyard is littered with companies that over paid for acquisitions. So get a handle on value to judge whether your CEO is a genius or a testosterone driven megalomaniac.

Having said that, I appreciate that not everyone can independently undertake corporate valuations, and if that's the case, look to the share price action for a guide.

The share price can provide a clue as to the general thinking on whether the scheme is likely to succeed. Typically, when the bid or scheme is announced, the share price will move closer to the offer price. It might even be higher if the market expects a better offer could emerge. And if the market thinks the offer is likely to fail, the share price could be lower than the offer price.

The final decision

Given the information above you have the following choices:

1. To sell on market before the offer expires if you are happy with the current market price.
2. Wait and accept the best offer. This means you will ultimately sell your shares directly to the highest bidder without paying any brokerage costs. You will receive payment by way of cash and/or shares as set out in the bidder's statement. But this begs the question – how often does another (better) offer arise after the first bid has been made? Logic suggests that the first offer won't necessarily be the last. It's a bit like buying a car – the potential purchaser often makes a low-ball first offer in the hope that the seller delivers a bargain - but is prepared to offer a higher price if the first offer isn't accepted.
3. You could reject the offer altogether. Generally you don't have to sell your shares to the bidder. But remember, if the bidder acquires a significant parcel of shares, then control of the company will shift in their favour. So understand what their intentions are with the company since they might not be aligned with yours or the other minor shareholders. Remember also that a large number of shares held by one owner can result in reduced daily trading volume in the shares of that company making buying and selling more difficult. And finally, when the acquirer obtains 90% or more of the company, they can generally compulsorily acquire your shares anyway.

With plenty of cheap mining, oil and gas assets on the market at the moment expect to see increased takeover activity in 2016. So if a takeover impacts any of the shares you own I hope this article helps you decide on the best course of action to take.

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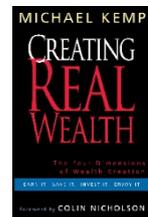
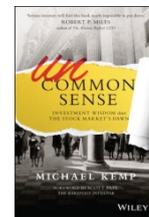
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