



Précis Paper

Takeovers

Introduction

In this issue of BenchTV, Karen Evans-Cullen and Lynda Reid conduct a rich and detailed discussion concerning takeovers. Key areas of the presenters' discussion are as follows:

1. When does an acquisition come under the takeover's regime?
2. The popularity of schemes as a form of takeover
3. Pre-bid preparation
4. Due diligence
5. Why do targets need to prepare for a takeover bid?
6. Tactics from the United States
7. What can Australian companies do to protect themselves from a takeover locally?
8. Focus points for target Board when an offer is made
9. What must a Board do when it receives an unannounced offer?

When does an acquisition come under the takeovers regime?

It is explained that there are a couple of key thresholds to be aware of in relation to takeovers law in Australia. The first is the 20% threshold, which says you can't

acquire more than a 20% interest in a listed company unless under one of the exceptions. Another key threshold is the 5% level, at which you must disclose to the market that you have a 5% or more shareholding in the company. It is noted that another thing to remember is that regulators are involved. The Takeovers Panel is a peer reviewed body appointed by the government responsible for resolving disputes concerning controlled transactions while the transaction is ongoing. There is also the securities regulator, ASIC, and the Court, if you are going through a court-approved scheme of arrangement. It is noted that there are two transactions for acquiring control: the takeover bid, governed by Chapter 6 of the Corporations Act 2001 (Cth), and the scheme of arrangement between the target company and the shareholders under which the target company shareholders transfer their shares to the bidder.

The popularity of schemes as a form of takeover

It is noted that in recent times there has been a real tendency for people to use schemes of arrangement, which provide greater flexibility to bidders as to the terms they can offer, and certainty of outcome. It is explained that the important thing about a scheme is that it requires cooperation of the target. It is further explained that bidders are reluctant to do transactions which don't have the target's cooperation because people have become more risk averse and want access to due diligence. It is noted that takeovers are now being left for hostile transactions and transactions where the bidder doesn't need to get to 100%.

Pre-bid preparation

It is explained that the first thing that a bidder needs to do is look at public information concerning the target and would also, in the preparation stage, consider whether to get a pre-bid stake in the target. The bidder needs to work out what they wish to achieve from the transaction and how to get to that. It is further explained that the bidder will need to think about the share register's composition. It is explained that the limits on the pre-bid stake are the 20% threshold, limits under the foreign investment regime (if you are a foreign bidder), and the need to make public announcement when the 5% threshold is crossed.

Due diligence

It is explained that in the past 5 to 10 years we have seen that bidders are needing more and more to undertake commercial or confidential due diligence before proceeding with transactions. It is further noted that private equity, in particular, will need to do due diligence due to reliance on leverage financing. Banks won't lend unless there has been some level of due diligence over what is publicly available. It is further explained that a Board is not obliged to give access to information but is obliged to act in shareholders' best interest: if a Board decides a proposal is not in shareholders' best interests it is quite within its rights to refuse access to due diligence, and it is then a question for the bidder whether to make public disclosure that the Board has rejected its informal confidential approach

Why do targets need to prepare for a takeover bid?

It is explained that preparing for a takeover bid is part and parcel of preparing for unexpected events in a company's life: A takeover response manual is prepared but generally, when a proposal arrives, the manual isn't brought out and laboriously worked through. What is most important is knowing how the market and your shareholders are going to respond to the offer. It is further explained that the share register must be constantly monitored so you understand whether somebody building a stake or, if not, then to determine: who are the shareholders making the decisions who you will need to talk to when dealing with a takeover proposal.

Tactics from the United States

The tactics of 'poison pills' and 'golden parachutes' are discussed: tactics such as these have been very common in the US but are perhaps becoming less favourable because of changes to corporate governance landscape due to shareholder activism. It is further explained that the tactics, in the face of a takeover bid, make the target much more expensive: with golden handshakes, for example, the executives get massive pay outs ,and poison pills refer to dilutive share rights,

in which a whole lot more shares are issued, making the target more difficult to acquire. It is explained that in Australia, mechanisms such as these are generally not permitted under the Corporations Act.

What can Australian companies do to protect themselves from a takeover locally?

It is explained that strong financial performance is the key: companies who disappoint the market provide opportunities, particularly for private equity, to think they can come in make money from turning the company around.

Focus points for target Board when an offer is made

It is explained that the target board compares the offer to three comparison points: 1. The target's current or historic market price 2. The bid price 3. The fundamental value of the target from the board's perspective, particularly in light of the strategies in place for where they intend to take the target business. It is noted that the target board must also assess, when making its comparisons, the risks in achieving its strategies, and consider how shareholders perceive the value of the company. It is explained that, as a target board you need to make sure you remain in control of the process so as to maximise value for shareholders, and that a bidder wants to minimise price and to create certainty of outcome, as well as flexibility to walk away if things don't work out for them in the bidding process. It is explained that the majority of takeovers are started by an informal approach in which bidder approaches the target. A confidential and indicative offer, for example in a letter, will set out the pricing, potential conditions, timing, and requests from the bidder. It is noted that if you are happy with a hostile approach you can announce your takeover to the market.

What must a Board do when it receives an unannounced offer?

It is explained that, when it receives an offer, a Board must consider whether its continuous disclosure rules require it to announce it, and whether there any

exceptions which mean that the announcement does not need to happen straight away. It is noted that provided the offer is confidential and incomplete the general rule seems to be that no disclosure to the market is required. It is explained that once an offer is leaked there will be a need to make disclosure to the ASX; that the only way to avoid disclosure is if the offer was illusory. It is explained that if an activist writes an open letter to a company there's no need to make disclosure if there's no actual formal offer on foot and they're not putting one. The Board however must consider the consequences of not making disclosure. It is explained that when you are acting for a bidder it is important to understand the bidder's strategy. It is further explained that generally you buy a company because you think you can extract greater value from it than the market is recognising, usually because you can extract synergies: costs synergies or earning synergies. It is noted that you want an advisor that can help with both planning and the detailed execution of that planning, and that whether you are acting for a bidder or a target preparation is key.

Bibliography

Corporations Act 2001 (Cth)

ASX Listing Rules

Presenters' Biographies:

Karen Evans-Cullen is a partner of PwC in the Legal Team. She is also a member of the Australian Takeovers Panel. Prior to joining PwC earlier this year, Karen worked at Clayton Utz, where she was a partner for 15 years. Karen has a Bachelor of Laws with first class honours from the University of Western Australia and a Masters of Law with distinction from Georgetown University. Karen has over 20 years' experience as a strategic mergers and acquisitions and corporate advisory lawyer. Karen is widely recognized as a leading M&A and governance lawyer in all major legal directories.

Lynda Reid had over 10 years' experience in transactions, corporate advisory and financial services matters. Lynda's expertise includes capital fundraising (listed and unlisted), public and private M&A, funds management, and financial services regulatory advice. Prior to joining private practice, Lynda practiced for five years with the Australian Securities and Investment Commission, and had a keen understanding of the Commission's operations and policies. Lynda has a Master of Laws from the University of Sydney, as well as a Master of Law and Legal Practice and a Bachelor of Business/Bachelor of Arts (International Studies) from the University of Technology, Sydney.