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THREE'S A CROWD, BUT DOES IT REALLY HURT TO HAVE AN INTERLOPER AROUND?

Five ways to make competitive tension work for a deal

Competition in the market for control of a listed company is nothing to be afraid of; quite the opposite. Shareholders ought to benefit from real competition, and both the perception and reality of competitive tension can provide a circuit breaker where there is a value gap (between target and bidders) or a prolonged period in play.

Increased regulatory scrutiny and ensuing deal delays are providing more chances for third parties to present compelling alternatives, especially when market values shift.

But what happens when an interloper - unlisted or otherwise - either doesn't present a competing proposal, or risks derailing the one you have? Listed companies and bidders bound by continuous disclosure and stakeholder expectations face challenges dealing with an interloper not similarly constrained. And what if 'agitation', rather than control, is the interloper's endgame? How do you respond as a listed company board?

This is a not-infrequent scenario in the West. Our private capital landscape has not only the well-trodden trails of private equity, but also, the occasionally steep and somewhat less predictable terrain of family office or 'billionaire' backing. And it can get very hot out there!

Below, we've pulled out the Top 5 rules of interloper engagement and added a note of encouragement when confronting the wallflower interloper.

1
EXCLUSIVITY AND OTHER DEAL PROTECTIONS SHOULD BE DETERMINED BY YOUR DEAL (NOT SOMEONE ELSE'S)

If you have organised a party for two, you have probably agreed exclusivity and other deal protections with the incumbent bidder, and perhaps a chunky break fee if one of you leaves the party early (or doesn't bother to bring any chips!).

It has become common place for the discussion to start with what's 'market' or what your legal or financial advisers – or you – agreed in the last deal.

But perhaps take a pause: any exclusivity and deal protections should be determined by your deal, the competitive dynamic for your company and the characteristics of you as target and that bidder. This better preserves competitive tension and the ability to adapt to changing market and control dynamics - while preserving the availability of a compelling proposal in the hand.

If you're the interloper, expect to challenge these protections to engage with the target company effectively. The first thing you're going to attack – and seek to challenge and even dismantle - are any fetters on the target's ability to properly engage on your competing proposal or legitimate concerns.

As a target, remember that securing a deal for your shareholders does not mean being disproportionately beholden to any deal or fettered in your ability to respond to shifting dynamics. Apply a cross-check between your proposed contractual framework and the actual market for control of your company, strike the right balance and don't be afraid of a little resistance and sometimes a lot of posturing from your party pal.

2

RESPOND, DON'T JUST DEFEND

The concept of takeover 'defence' is outdated. Instead, focus on extracting the best value or outcome for shareholders and mitigating downside risks. The target company's best interests (which typically equates to those of its shareholders as a whole) are the North Star for every director decision. There is always a price at which control will pass. So the response objective ought be extracting compelling compensation for ceding control, securing it for your shareholders, and protecting them from some downside risk along the way.

Of course, an interloper may well have no basis for presenting a compelling counter proposal, or there may be no other merit in its disruption of the existing proposal. That's for the target and its advisers to interrogate; objectively and without fear or favour to the incumbent. Where a private capital interloper is concerned, the analysis can be more nuanced; which is where the next rule plays a vital part.

3

KNOW YOUR VALUE PROPOSITION AND POTENTIAL WEAK SPOTS, AND REVISIT ALL THE TIME

Knowing your value, your market, your business and your peers are all essential elements of corporate hygiene. But being able to self-interrogate your business, its value and its potential weak spots, as if you were an interloper, is something else again. This self-awareness allows you to anticipate an interloper's moves and address shareholder concerns proactively.

The alternative is unpleasant - where material, neglected concerns of your major shareholder/s muddy the narrative of an otherwise attractive proposition; which segues nicely into the next rule.

4

KNOW YOUR INVESTORS BETTER THAN ANY INTERLOPER – AND COMMUNICATE, COMMUNICATE, COMMUNICATE

Like value, knowing your key stakeholders and what they think of your company and your relationship is not something to initiate once you're in play. That foundation is something to build and maintain, so that when an approach comes – and if you are successful, it will – you're starting from a strong base of mutual understanding.

Investor relations need to build from that base and shift up a gear when an interloper appears. Communicating in an open and timely manner with key stakeholders, and tailor-ing the communication to their needs, is how a company can transform its response from one that is vulnerable (to the drama of rhetoric and market speculation) to one that is measured, informed and better positioned for broad-based shareholder support from the get go.

Afterall, early momentum is what brings deals to life, and can stymie agitation for agitation's sake.

5

DON'T BE AFRAID OF THE TAKEOVERS PANEL

Interlopers and incumbent bidders commonly make strategic use of the Takeovers Panel in an actual contest for control. Listed company targets should too – as a tool to serve the company's best interests (provided the target has not itself contributed to the alleged unacceptable circumstances – as the Panel is generally reluctant to second-guess a well-advised board).

The Panel is not a forum for seeking to create nuisance or unjustified delay and yes, it's hard being disciplined when other parties appear less inclined to behave. But being prepared to hold control participants to account, in a measured and tactical manner, can provide demonstrable evidence (for key shareholders and other stakeholders alike) that their company is in safe hands with directors, and advisers alike, who hold their best interests paramount.

TOO SHY (TO BID)?

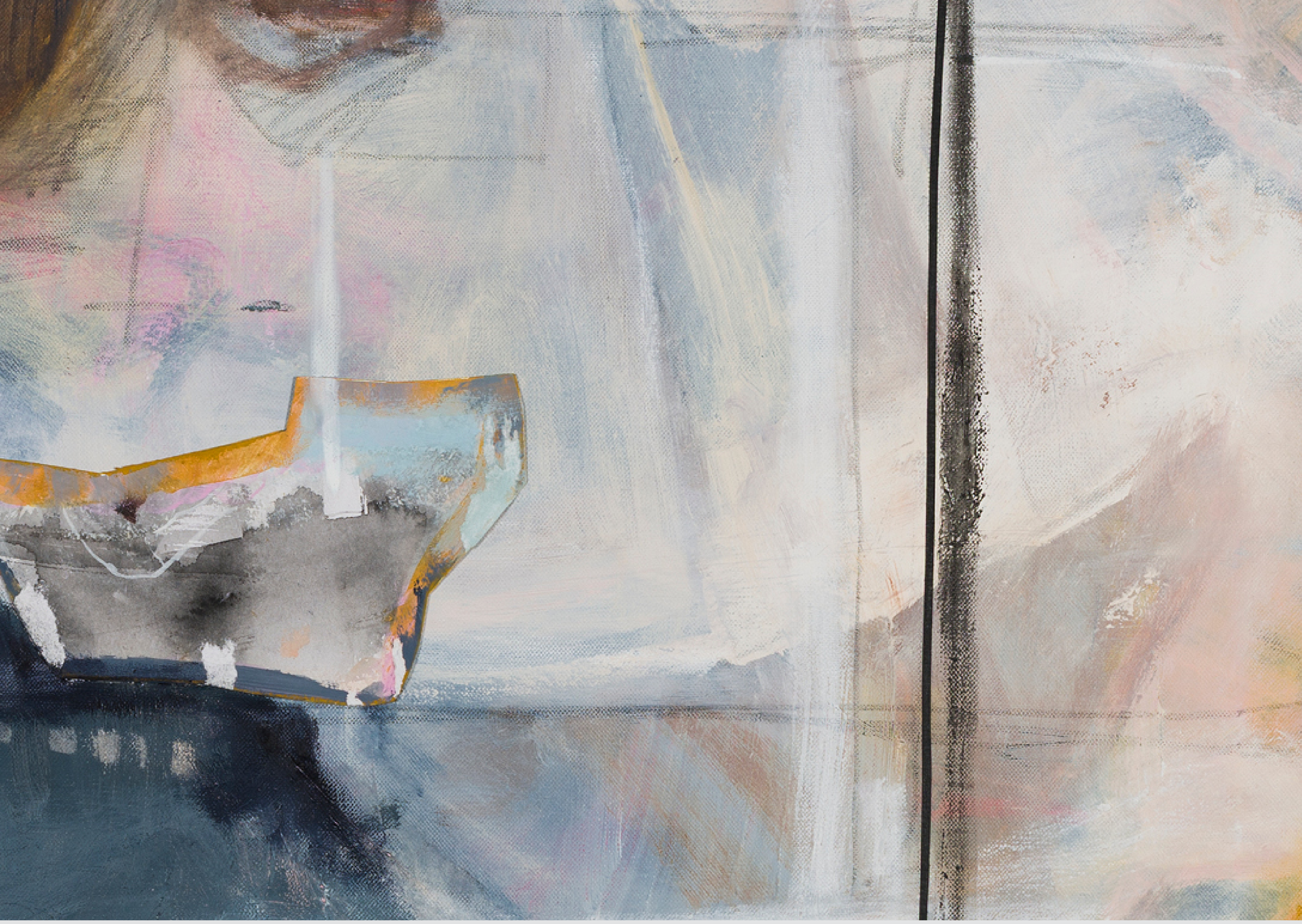
Not everyone wants to be the life of the party, and that's equally the case in a market for control. If encouraged out of their shell, the seemingly shy ones can sometimes surprise you! But how do you deal with a major, potentially blocking shareholder who is too 'shy' to bid themselves, when they are either on the fence or (either quietly or noisily) bringing down the vibes? In cases where a major shareholder is hesitant to bid, consider a dual approach: a scheme of arrangement with a fallback takeover offer. This empowers shareholders to control the outcome and better supports a fair price.

By definition, a *scheme* must always have a minimum acceptance threshold - 50% of shareholders in number present and voting at the scheme meeting, plus at least 75% of the votes cast. Depending on the turnout at the scheme meeting, a major shareholder with ~19% (and even quite a bit less) is going to be able to block the scheme. Contrast a *takeover offer*, for which a sufficiently bold bidder is not required to set a minimum acceptance condition.

Under the parallel approach, the bidder launches a concurrent scheme of arrangement at a particular price, together with a fallback takeover bid (but without a minimum acceptance condition) at a lower offer price. This is intended to encourage shareholders to go with the higher-priced scheme (which, if successful, would guarantee the acquisition of 100% of the target), but if the scheme is defeated or otherwise doesn't proceed, the takeover offer remains 'in reserve' and available to those who are prepared to exit at the lower price – countering that downside risk we mentioned earlier. The lower offer price is justified on the basis that, without a minimum acceptance condition, the takeover mechanism might not deliver control to the bidder.

While a two-pronged proposal can ultimately help unlock a deal (that would otherwise be blocked by an interloper), it can leave a control situation unresolved. That's rarely ideal. And it does take a bit of explaining to shareholders – they aren't invited to two parties, just the one, but will it end in a dance off or an early exit?

The lesson? Dealing with an interloper requires a mindset for strategic engagement and clear communication. The rest is just tactics (and dance moves).



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