Trends in M&A activism: M&A as an activist demand, 'deal' activism and 'industry competitor' activism

M&A activism has recently been highlighted as one of the current trends in shareholder activism, and boards and executives should be aware of how it might impact their companies. Broadly, activists can influence M&A activity in three ways.

M&A as an activist demand

First, M&A activity can be an activist demand in itself. This is usually the work of activist hedge funds, who acquire stakes in companies which they believe are underperforming and publicly and/or privately agitate for change. Hedge funds have been particularly active in the US, where they have often focused on improving corporate governance (either as an end in itself, or a means to some other aim), increasing the amount of capital returned to shareholders, or making operational changes to increase profit or cut costs. Increasingly, activists are also campaigning for some form of M&A activity, for example, by pressuring companies to de-merge or to spin off or divest non-core assets, to merge or acquire assets, or more fundamentally to sell themselves or make themselves a more attractive target for potential bidders.

Just a selection of recent examples reported by the US media include:

- Yum! Brands announced plans to spin off its China business, which was attributed to pressure from activist hedge fund Corvex Management;
- EMC Corp's decision to sell to Dell was attributed to pressure from activist investor Elliott Management;
- activist fund Pershing Square acquired a stake in Mondelez International which some analysts believe is an attempt to push the company to sell itself;
- following pressure from activist investor Jana Partners, Qualcomm agreed to consider a spin off of its chip business;
- activist Starboard Value announced a stake in Macy's and called for the company to spin off some of its real-estate assets;
- Staples' offered to buy Office Depot following calls by activist investor Starboard Value for a merger;
- activist Elliott Management called on Citrix Systems to, among other things, sell or spin off a number of its smaller operations; and
- activist Carl Icahn announced a 'large stake' in American International Group (AIG), and called for the company to split into three public companies to avoid the designation of a 'systemically important financial institution'.

In the US, there has been an increasing amount of research attempting to work out whether or not these strategies actually make money for activists (and other shareholders). For example, a study by Proxy Masaic found that divestitures and spin-offs do unlock shareholder value, and that the unlocked value is 'reasonably sustainable'. However, in contrast it found that strategic acquisitions have resulted in the destruction of shareholder value (and therefore might be better left to management).[1] Another recent study by US academics from Northeastern University and the University of North Carolina[2] found that: firms targeted by hedge fund activists subsequently face a high likelihood of becoming a takeover target; this is not due to selection by activists of likely targets but is a result of a 'treatment effect' (for example, operational policy improvements as a result of the activist's intervention); and firms that are acquired following shareholder activism display large positive long-term excess returns, while firms that do not receive a takeover bid display no evidence of long-term stock price outperformance (according to the authors, suggesting that the primary channel through which shareholder activism creates value is by 'putting firms in play'). In addition, their findings suggest that activist hedge funds facilitate the merger process by helping target firms find better merger partners, therefore leading to higher expected merger synergies, and that the overall positive returns associated with activism are not simply due to the activists' picking firms 'for which potential acquirers might overpay'.

The existence of empirical evidence indicating that there is money to be made by activists pushing companies to undertake M&A activity suggests that the trend is likely to continue and possibly increase, and in indeed a number of studies this year support this view.[3] Although generally speaking the focus of this trend appears to be in the US, there have been a number of recent reports that M&A activism is also on the rise in Canada, including because changes in the energy sector are prompting activist hedge funds to push companies to look at mergers and acquisitions or asset sales to reduce costs, as well as to help the funds reduce their own investment losses.[4] As for Australia, there have been a number of recent predictions that the market here should expect to see increased levels of activity by activist funds.[5] A number of dedicated activists funds are now established in Australia, for example Alex Waislitz's Thomey Opportunities Fund, Mark Carnegie's Companion Fund and Gabriel Radzyminski's Sandon Capital Activist Fund. Minter Ellison's M&A team has predicted in its Australian M&A Outlook for FY16 that there will be increasing M&A activity initiated by these types of dedicated activist funds.[6]

There are a number of key steps that boards and executives should consider undertaking to prepare for and respond appropriately to an approach from an activist, including any approach advocating that the board pursue M&A activities. For example, to prepare for activists it is suggested that boards acknowledge and close any significant weak spots in financial performance, evaluate the board to ensure it adding maximum value, know their shareholder base and carefully monitor changes to the register, proactively communicate strategy to the market and engage frequently and effectively with key shareholders. Following an approach by an activist, boards are advised to, among other things, listen to the activists proposals with a neutral, open-minded attitude and consider communicating with them privately, form a response team made up of the right internal people, with the benefit of specialist external advice, and focus on engaging with the activist on the merits of their proposals.

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[1] Proxy Mosaic, 'Beware of Activists Bearing Formulas: Activist Investors and the Success of Financial Engineering' June 2015

[2] Nicole M. Boyson, Nickolay Gantchev and Anil Shivdasani, 'Activism Mergers' 21 Oct 2015: SSRN (10 Nov 2015)

[3] For example, see discussion under 'Shareholder Activism' in the Governance News 21/7/15 and 13/10/15

[4] For example, see discussion under 'Shareholder Activism' in the Governance News 18/8/15 and 13/10/15

[5] Ibid

[6] MinterEllison, 'Directions in Public Mergers & Acquisitions' 2015/16 edition

'Deal' activism

The second way that activists can impact M&A transactions is by agitating for changes to the terms of an M&A deal that has been announced, for example, to attempt to obtain a higher price from the bidder or other improved terms, to seek a higher price from a competing bidder, to pressure a board which has rejected a formal offer or dismissed an indicative offer to reconsider its view and engage with the bidder, or to try to prevent a deal which they don't support. In this situation, the pressure may not come from an 'activist' as such, but from a more traditional existing institutional shareholder or a founding shareholder. Alternatively, it may come from an activist who acquires shares specifically for the purpose of improving the terms of an announced deal and making money on its investment (known as 'deal arbitrage'). In any event, tactics employed may be similar to those of activist funds, for example, the shareholder may apply private or public pressure on the relevant boards, with threats of withholding votes or taking other action.

Minter Ellison's M&A team identified this kind of deal activism as one of the key themes of the Australian M&A landscape for FY15, noting some examples of deals in the Australian market that have seen pressure from 'activist' shareholders (including the Roc Oil/Horizon 'merger of equals', TPG's recommended takeover offer for iiNet, and Baytex's recommended takeover offer for Aurora Oil & Gas).[7] They advise that these examples 'reinforce the importance of boards of both bidders and targets being attuned to the likely attitude of key shareholders', and that '[a]lthough boards should always exercise independent judgment and not be unduly influenced by the views of key shareholders, a failure to anticipate and address their concerns increases the risk of a protracted, expensive and potentially failed transaction.' Looking forward, the M&A team predicts that the course of M&A transactions in FY16 is likely to continue to be influenced by activist pressure applied by key shareholders of the target and the bidder, and advises that '[n]ow more than ever, boards need to anticipate all angles of potential challenge to their deal structure and terms', and 'to be prepared to adapt their structure and/or terms in response to increasingly sophisticated avenues of challenge by activists looking to improve the originally announced deal'.

In the US, companies have been facing this kind of activism for some time, often from fairly aggressive hedge funds, and recent studies suggest deal activism may be on the rise there as well.[8] In a recent post on the Harvard Law School Forum on Corporate Governance blog, Adam O. Emmerich, partner in the corporate department at US firm Wachtell, Lipton, Rosen & Katz, discussed trends in 'deal activism' from a US perspective.[9] Mr Emmerich notes that of the public activist campaigns over the past five years seeking to disrupt deals involving at least one US company, two-thirds involved hedge funds (which he says often bought in only after a deal was announced). However, interestingly less than one-third resulted in increased consideration for the target's shareholders, whether from the original acquiror or another buyer; and 'barely one in ten resulted in an abandoned deal'. He said that in fact, in most deals, the transaction is completed on the original terms despite activist attacks, albeit with increased costs, uncertainty and distraction for all parties involved, and that '[v]alue-creating deals… continue to be identified, entered into and consummated, even when activists are involved.' In addition, he notes that 'just as US investors have exported general activism abroad, US hedge funds increasingly consider agitating against non-US deals, often leveraging the idiosyncrasies of local laws to seek special benefits while deploying other US-style tactics.'

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[7] MinterEllison, 'Directions in Public Mergers & Acquisitions' 2015/16 edition
[8] For example, see *Activist Insight Activism Monthly Lite*, Volume 4, Issue 8 September 2015
[9] Adam O. Emmerich, 'Deal Activism' 27 October 2015: *Harvard Law School Forum on Corporate Governance and Financial Regulation* (27 Oct 2015)

In the US context, Mr Emmerich advises that as well as putting in place the usual activism 'preparedness and response', in the 'special context of deal activism' boards should consider some other key steps, including for example: ensuring a robust board process for evaluating the potential transaction and options and maintaining a proper record of board review and deliberation; considering the respective companies, deal terms and overall situation from an activist perspective, including tools and accumulation strategies activists might use and how to respond and defend against them; anticipating possible attacks by analysing the shareholder base and how it might change; and developing and executing an effective roll-out and communications plan ('a top priority').

'Industry competitor' activism

A third way activists can intervene in M&A transactions is a variation on 'deal' activism. It involves an industry competitor buying a key stake (or increasing its existing stake) in a target company on market, after a merger or acquisition is publicly announced but before it is completed in order to disrupt the merger or acquisition. For example, the industry competitor may want to prevent the deal because it is concerned about the impact of the transaction on its market position if it proceeds, or may want to use its stake as leverage to obtain a strategic benefit for itself. Minter Ellison's M&A team also identified this type of activism as a key theme in Australian M&A activity in FY15, and predicted that it is likely to continue as a trend in FY16.[10] As with deal activism generally, it recommends that boards ensure they are prepared to adapt their structure and/or terms in response.

A recent interesting example of this type of 'competitor' activism is Qube Holdings Limited (Qube)'s intervention in the proposed takeover of Asciano by Canada's Brookfield Infrastructure Partners (Brookfield). The Asciano board had recommended shareholders approve the proposal, to be implemented by way of a scheme of arrangement, and it was originally scheduled for a shareholder vote on 10 November.[11] As a scheme of arrangement, the proposal needed to be approved by at least 75% of the votes cast (as well as by 50% of the shareholders who vote). In what was reportedly a surprise move on 30 October Qube announced that, with the support of two co-investors, Global Infrastructure Partners (GIP) and Canada Pension Plan Investment Board (CPPIB), it had acquired a stake of 19.99% in Asciano.

According to its ASX announcement, Qube's intention is to 'participate in deciding the ownership of Asciano's first class Australian terminal assets', as it believes 'a strategic combination' of Qube with the Patrick Containers Terminals business as well as a small number of other assets currently owned by Asciano 'has the potential to create significant value'. Qube said that it has no 'present interest' in acquiring any of Asciano's businesses beyond those specific assets. According to the announcement, the consortium members do not support the Brookfield scheme proposal and do not intend to vote in favour of it. Instead, they intend to evaluate a number of options in relation to Asciano, including: not voting any Asciano shares in favour of the current Brookfield scheme of arrangement; entering into discussions with Brookfield and/or Asciano in relation to an alternative transaction to the

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[10] MinterEllison, 'Directions in Public Mergers & Acquisitions' 2015/16 edition, also see Alberto Colla, 'When a suitor comes calling - Key developments and trends in M&A' (2015) 67(5) *Governance Directions* 286, which cite: Vocus Communications' recommended scrip takeover offer for Amcom Telecommunications (by scheme) which was disrupted by another industry participant, TPG Telecom; Saputo's attempted takeover of Warrnambool Cheese & Butter (WCB), which was disrupted by Lion Dairy & Drinks a key customer of WCB; and Solomon Lew's disruption of Woolworth's takeover of David Jones to force Woolworths to buy his long term shareholding in Country Road at a significant profit as examples of 'industry competitor activism'

[11] Brookfield Infrastructure press release 17/8/15

current scheme involving the possible carve-up of Asciano's assets; and/or holding a strategic stake in Asciano for a period of time, which may include seeking board representation.[12] Qube's stake meant that for the proposal to pass, Brookfield would have needed almost all other shares to be voted in favour, and a number of media commentators asserted that Qube's intervention had effectively killed Brookfield's proposed deal and the parties will be forced to negotiate with Qube if they want it to progress.[13] In a letter to shareholders, Asciano chairman Malcom Broomhead said that the Asciano board continued to unanimously recommend that they vote in favour of the Brookfield scheme 'in the absence of a superior proposal', and that the Asciano board was considering the implications of the Qube acquisition.[14]

In a subsequent development, Brookfield announced that it had acquired approximately 188 million shares in Asciano, representing around a 14.9% interest in the company, and had entered into arrangements giving it economic interests in a further 4.3% of Asciano.[15] According to Brookfield's announcement, 'subject to agreeing to a bid implementation agreement with Asciano, which is being progressed, Brookfield Infrastructure intends to make a takeover offer for Asciano for the same consideration as the 'standard consideration' under the existing scheme of arrangement', which would be subject to a 50.1% minimum acceptance condition and would have similar conditions to the scheme of arrangement, including ACCC merger clearance.

After that announcement, Asciano issued a number of statements notifying shareholders that:[16]

- the scheme meeting scheduled for 10 November had been deferred to a date to be determined;
- that it had entered into an Implementation Deed with Brookfield, under which a subsidiary of Brookfield will make an off-market takeover offer for all remaining Asciano shares it does not own, with the same consideration as the Standard Consideration proposed under the Scheme of Arrangement (an implied value of A$9.21 per Asciano share); and
- following that, it had received a non-binding indicative proposal from Qube, GIP and CPPIB to acquire all of the issued share capital of Asciano not already owned by the Qube consortium (at an implied value of A$9.25 per share) which the Asciano Board is considering.

How this situation plays out will be interesting to watch, and is likely to involve some valuable lessons for other Australian companies in the current M&A climate.



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[12] Qube ASX announcement 30/10/15
[13] See for example The Australian Financial Review 31/10/15 and The Australian 31/10/15
[14] Asciano news release 2/11/15
[15] Brookfield Infrastructure press release 5/11/15
[16] Asciano media releases 9/10/15, 9/10/15 and 10/11/15