Activist Investing: A Fresh Look at Takeovers

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The rise of hedge funds to preeminence during this decade led to increased shareholder activism and, in turn, to a new focus on the tools shareholders may use to increase their leverage with company management. Moreover, with the dramatic changes in valuations over the last year or so, activist investors are seeing new opportunities to seize value. In some cases opportunities arise where the investor already has a stake in a company whose valuation plunged and may yet be substantially below the investor's target price. In other cases, the investor may merely have identified a value proposition. In both cases the valuations may be at a price that causes the investor to consider taking a substantial stake in the company, if not acquiring it altogether, in anticipation of valuations ramping back up in the new business cycle. These new circumstances have led us and a number of our clients to take a fresh look at the tools that we may bring to bear in this environment. We focus here on three such tools: a tender offer, a proxy contest, and a private placement.

Of course, before considering the appropriate method with which to approach the target company one must carefully review the target company's antitakeover mechanisms as well as other corporate impediments that may hinder or delay a transaction. These range from poison pills and antitakeover statutes to the rights of shareholders to remove directors with or without cause and the ability to call special shareholder meetings. Antitakeover measures, such as poison pills, have declined in use somewhat over the last few years, but they can still cause significant complications. Nonetheless, even when a company is considered practically immune to a takeover, there are options available to bring substantial pressure on the target board of directors to give due consideration to a takeover proposal. It should be noted, however, that stalking a target in this manner can take substantially more time and may have to be accomplished in several different steps. The focus of this brief discussion, however, is on the specified acquisition techniques rather than on the myriad takeover defenses and their countermeasures.

Tender Offers

A tender offer is one of the most direct ways to take ownership of a company. In a tender offer, the offeror makes an offer to all shareholders of the target at a specified price. Shareholders wishing to accept the offer must tender their shares prior to the termination date of the offer. Of course, to induce offerees to accept the offer, the tender offer price is set at a premium to the market price of company's stock.

The ordinary tender offer can be a somewhat expensive and time consuming undertaking. It requires the drafting of tender offer documents, filing the documents
with the Securities and Exchange Commission, and the placement of an advertisement (i.e. summary publication) in a national newspaper, as well as paying related filing fees and engaging an information agent and a depositary to handle the various information requests and exchange of cash for securities. Recently, however, our firm was able to obtain no-action relief from the SEC staff in connection with a number of tender offers that allowed us to reduce some of these costs primarily by utilizing electronic means of delivery to satisfy the publication and dissemination requirements of Rules 14d-4 and 14d-6 of the Exchange Act. This relief allowed our client to publish a widely disseminated press release through an Internet-based news service (such as Business Wire) in lieu of purchasing an expensive print ad in a national newspaper. In each tender offer, the press release contained the same information that would have been included in a summary publication, but at a small fraction of the cost. Additionally, the client made the tender offer documents available to shareholders on a dedicated website rather than incur the cost of initially mailing them to each shareholder. Our client even decided to forego the use of an agent and handled all inquiries and tenders himself with the help of the Depository Trust Company, which substantially eliminated the costs of the information agent and the depositary.

Tender offers can also be made for less than all the shares of the company. In many cases, other than where one is intent on buying the entire company, an activist shareholder’s goals can be met by owning far less than all of the company's shares, and even less than a simple majority. The fact of initiating the tender alone can put a great deal of pressure on the board of directors, as the board must respond to the tender by giving to all shareholders within 10 days a statement disclosing its recommendation (for, against, neutral, or unable to take a position) and reasons for its position. While the offer must not be illusory and the offeror must be ready, willing, and able to purchase the tendered shares pursuant to the terms of the offer, there may also be a number of opportunities along the way to come to terms with the board and voluntarily withdraw the tender.

Proxy Contests

Sometimes it is necessary to first gain some control of the board of the target company in order to remove antitakeover obstacles or take greater ownership of the company. In that case, a proxy contest may be in order. The simplest form of proxy contest seeks control of the board by offering a competing slate of directors at the company’s annual meeting of shareholders. Like the tender offer, the ordinary course proxy contest requires the drafting of a competing proxy statement that is filed with the SEC and the hiring of a proxy solicitor to attempt to gather the votes. Many filers take advantage of the relatively recent e-Proxy options that are available, which can represent significant savings over traditional "print and mail" proxy contests due to the reduced printing and mailing costs. In any event, to the extent extraordinary efforts are required to get out the vote, costs can correspondingly increase.

Because shareholder apathy can be a significant obstacle to success in a proxy contest, one way the activist investor can help ensure that shareholders pay greater
attention is to hold the proxy contest in conjunction with a partial tender offer that is contingent upon the success of the proposed slate of directors. That way, otherwise apathetic shareholders who might have ignored the proxy will be incentivized to vote for the activist investor's slate if they wish to capture the offered premium on the tender of their shares. The perceived shareholder incentive can be further increased at relatively low cost by offering a large premium while only seeking to purchase a relatively small percentage of the company. Although shareholders who tender their shares will be cut back ratably such that the offeror's overall premium exposure is limited to the total amount of the tender offer, shareholders may not wish to take the chance of losing out on that premium even if it would likely represent a small portion of their holdings. Accordingly, adding a partial tender offer to a proxy contest can improve the odds of success of the proxy contest.

The proxy/partial tender can also be useful in applying pressure to companies with antitakeover measures in place. By necessity, tender offers are frequently conditioned on the waiver or removal of such measures, as the success of the tender offer may be otherwise prohibited or limited. Again, because of the incentive provided by the premium in the tender offer for non-interested shareholders, an offeror may increase the likelihood of prevailing in the proxy contest while correspondingly increasing the pressure on incumbent directors to negotiate with the activist investor in advance of the shareholders meeting to seek a resolution.

Private Placements

Private placements are not usually discussed in the context of takeovers, as they are generally thought of in the context of corporate finance. However, there are some distinct advantages for the activist investor who purchases control of a company through a large private placement of shares directly from the company rather than from the public shareholders. This alternative allows the investor to infuse cash into the company while obtaining control through the issuance of a large block of freshly minted shares. Of course, this approach adds the hurdle of requiring the company's cooperation, but it can also be accomplished as a second step following the proxy or proxy/tender offer alternatives described above. In many cases such a private placement will involve paying a control premium for the shares, but it may well be less than that paid in the tender offer context. This is generally because the investor will purchase unregistered shares and is able to negotiate the premium amount directly with the company. In any event, the investor will be deemed to hold affiliate or restricted stock because of the control nature of the relationship the investor gains with the company through any of the options we have described. Thus, the investor will likely be indifferent as to whether the stock is registered or not. In addition, the issuance of a large block of shares will almost always require the approval of shareholders and will be highly dilutive. However, given the potentially significant infusion of capital into the company in these financially challenging times, shareholders may view the proposed private placement positively despite the significant dilution that would result.

The distinct advantage of purchasing a control block in a private placement over market purchases is that the invested capital remains in the company rather than in
the pockets of what would otherwise be former shareholders. As a result the activist investor has gained control of a company that is far better capitalized. This capital will further enhance the company’s ability to survive economic challenges, and there remains a ready exit (as the company remains public) when the time is ripe.

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These are just a few of the tools that can be brought to bear in the service of activist investors. Nevertheless, they are only tools. The real key is the investor’s confidence in the viability of the target company. If the overall investment thesis looks compelling, these tools can be quite useful in maximizing investment returns.

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1 The initial filing typically includes the following documents: (i) Schedule TO, (ii) Offer to Purchase, (iii) Letter of Transmittal, (iv) Notice of Guaranteed Delivery, (v) Letter to Brokers, Dealers, Commercial Banks, Trust Companies, and other Nominees, (vi) Letter to Clients for Use by Brokers, Dealers, Commercial Banks, Trust Companies, and Nominees, (vii) Guidelines for Certification of Taxpayer Identification Number on Substitute Form W-9, and (viii) press release announcing commencement of the tender offer.


3 In our no-action request, we argued that electronic publication and dissemination should be permitted because (i) Rule 14d-4 provides offerors with discretion in determining whether a method of dissemination is adequate, (ii) it is consistent with the SEC’s recently stated beliefs, initiatives, and guidance (e.g., the e-Proxy rules and the stated support of the access-equals-delivery paradigm), and (iii) it provides far greater distribution than that of a summary advertisement in a newspaper and does so at a significantly lower cost. While the SEC staff did not respond in writing or publish our request, we received verbal confirmation before proceeding with the tender offers. See, e.g., MFS Government Markets Income Trust, Tender Offer Statement (Schedule TO) (Sept. 12, 2007).


5 Regulation 14E of the Exchange Act.


7 Rule 14a-16 of the Exchange Act.

8 Rule 144 of the Securities Act of 1933, as amended.

9 NYSE Listed Company Manual Section 312.03(c) and NASDAQ Listing Rule 5635(d).