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Inbound M&A: What directors need to know

JUNE 27, 2018 5 MIN READ

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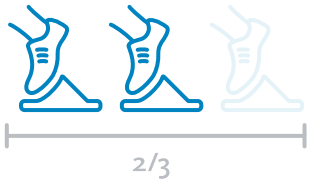
To sell, or not to sell: It's a high-stakes decision most public company directors confront at least once in their boardroom careers. Whether the process begins with a friendly offer or a hostile ambush, the steps directors follow and their ultimate decision will frequently be the biggest, most scrutinized action of their service.

Recognizing this, Osler, in conjunction with the Institute of Corporate Directors (ICD) prepared a survey of director views on M&A, which was then sent to the ICD membership. The ICD and Osler then convened a group of experienced corporate directors to participate in a roundtable discussion on lessons learned, trends in the survey, special committees, the new takeover bid regime and more. This article summarizes some of key areas highlighted in the survey and the roundtable discussion.

Is your board M&A ready?

Two-thirds of surveyed directors believe that M&A experience should be a core area of functional expertise in the board skills matrix.

Roundtable members generally agreed on the need for advance planning, regular reviews of defensive measures and established processes for assigning responsibilities and identifying advisors once a bid arrives. Several also stressed you should never assume your company isn't a potential target, but those in a slumping sector or with a low valuation should be on highest alert.



A proposal arrives: What now?

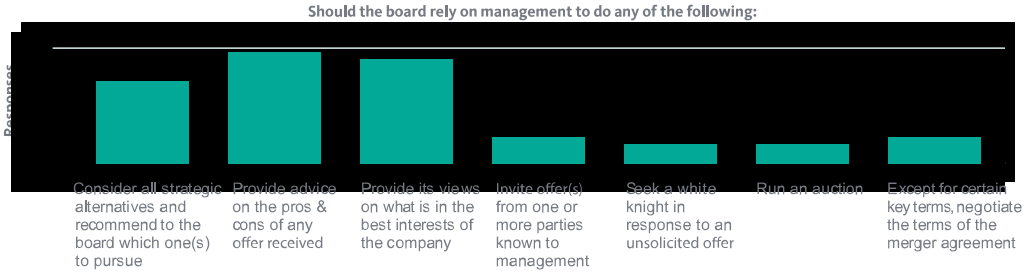
Management is normally the first point of contact for suitors and shareholders, which means the CEO can typically control the flow of information to the board. Yet management also has a vested interest in any potential transaction. The board needs to establish guidelines as to

what comes to it and when, as well as which decisions require board approval.

Directors want to be informed about acquisition proposals. Over 53% of survey respondents said they believed every unsolicited acquisition proposal should be brought to the board. Another 42% also said yes unless the offer is clearly not credible.

The top two areas where directors expect management's support are: considering the pros and cons of any offer (89%) and management's views on what is in the best interests of the company (83%). While management will typically lead negotiations, roundtable directors stressed that it's important that the board be involved.

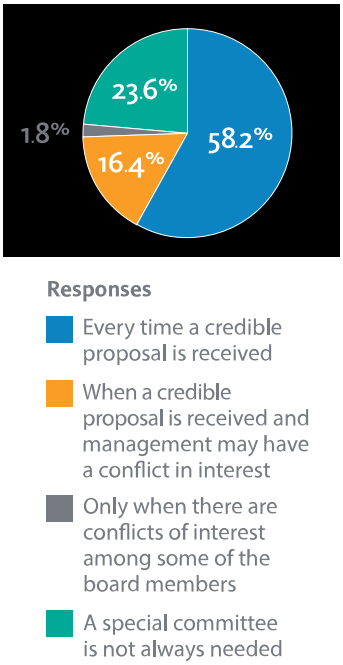
Key decisions for directors include: approving the general approach to the sale process, controlling access to confidential information, determining the board's response to a credible proposal and making the decision whether, and when, to recommend a sale.



Do you need a special committee?

There are differing views on the use of special committees. Some 58% of survey respondents said a special committee should be established every time a credible proposal is received, while 23% said a special committee is not always needed. Another 16% would do so only if the proposal is credible and management may have a conflict of interest.

In addition to circumstances where a special committee is legally required, roundtable participants favoured their use to manage conflicts of interest with management or among board members. They also recognized that special committees can be warranted where certain directors have more time or expertise to deal with a sale process. However, there are potential drawbacks to so-called "committees of convenience". As one roundtable participant said: "As a director, I'm not interested in delegating to other directors the biggest decision the board makes."



Seeking external advice

More than 90% of the surveyed directors agreed that a board can just say, "No," to a credible offer the board believes is not in the company's best interest. Roundtable directors were comfortable making that determination without external advice unless the offer price was in a "grey zone." Then they'd consult a valuation expert. "You've got to ask yourself, and be seen to ask yourself, the right questions," said one director.

Many survey respondents (72%) support engaging investment bankers when trying to bring other bidders into the mix. Roundtable directors agreed that advice from legal counsel with public M&A expertise is essential, and independent external counsel is an asset when management is conflicted.

Communicating with shareholders

Shareholders ultimately decide whether the sale will happen. Shareholder engagement can be challenging if public announcement of a bid leads to rapid changes to a company's shareholder base as short-term speculators move in. The Board needs to be attuned to changing shareholder sentiment as it decides how to communicate its views on any offer.

New bid regime

Since the adoption of the new take-over bid regime in May 2016, which requires hostile take-over bids to be outstanding for 105 days (unless the target enters into an alternative transaction or the target board agrees to shorten the bid period), there has been some debate as to whether this is the appropriate length of time for target boards to respond to a hostile bid. Under the old regime, where bids only needed to remain open for 35 days, target boards, in order to buy time, would adopt a shareholder rights plan, or "poison pill" – a provision that potentially would dilute the buyer's stake in the target. Pills were typically cease traded after 45-70 days. One roundtable participant said "In the old days, you were in a race and risked not getting maximum shareholder value".

While 62% of survey respondents agree that short term investor interests play too significant a role in determining the outcome of acquisition transactions, almost 70% agree that the new 105 day takeover bid regime is working to provide sufficient balance against short term investor pressures.

Conclusion

The survey and roundtable discussion confirm that M&A transactions pose a number of unique and challenging issues to directors. Every public company board needs to be comfortable that collectively it has the experience and skills, and access to resources and support, needed to respond effectively when confronted with a potential sale.