Online Class / Week #8 http://eval.ou.edu

- Complete discussion of poison pills
- (2) Regulation in M&A

  (3) Convail A&B cases

Course Evaluation:

eval. ou. edu

Thank you for taking the time to complete it!

V Final Exam

- Wednesday, 12/, 12:01 am CST Sunday, 12/12, 11:59 pm CST
- 90 + 5 minutes to complete
- Five questions, selected at random from the list of eligible questions

(Continuation from last class)

MRA Defense Mechanisms Mechanismi staggered board V - poison pill - super majority requirement to amend charter on byland - dual class structures External Mechanisms: - Regulators - Activist investors - Market for corporate control

Discussion of Takeover Defenses & Poison Pills

Shadow pill vs. poison pill

A visible poison pill = A discriminatory dividend rights plan!

Example:

Flip. Over Pill Example: (more common in Europe)

Before 51% (sh)

5eller [49 ]. (sh)

After merger W/ Slip-over pill

51+0

49 + 49 newly issued shares (as dividends)

 $\frac{51}{51+98} = 34.2\%$ 

 $\frac{98}{51+98} = 65.8\%$ 

Discussion of poison pills a discriminatory dividend play Poison pill executed by the corporate board against an acquirer (unsolicited) who acquires X%.
or mote of the target stock. - every one else among shareholde gets stock dividend @ - control-seeking acquirer does not get such dividend discount price - usually X is 6%

Poison pills types: Conrail had it; it permits sharehold V - flip - 17 -except acquirer, to purchase additional shares of a discount. It dilutes shares held by hostile acquirer while such acquirer is attempting to gain control. Enables shareholders (who do not seek control) to purchase acquirer's shares after merger @ a discount

#### Poison Pill

Tactic utilized by companies to prevent or discourage hostile takeovers.

Types:

1. "Flip-in"

Permits shareholders, except acquirer, to purchase additional shares at discount. It provides investors with instantaneous profits & dilutes shares held by the acquirer.

### 2. "Flip-over"

Enables stockholders to purchase the acquirer's shares after merger @ discount. For example, shareholder has right to buy stock of acquirer in subsequent merger @ two-for-one rate.

### Standstill agreements

The target's final concern is that having divulged its trade secrets to the buyer, the buyer will short-circuit the merger negotiations and proceed to acquire the target through open market purchases or a tender offer directly to target shareholders. Some confidentiality agreements shares of the seller for a specified period of time of the buyer is sometimes more broadly draft solicitation unsolicited tender offers or proxy solicitations.

The buyer will often request that the standstill sinterest in the target, up to 4.99 percent of its shares that are threshold for reporting the equity. will prohibit the acquirer from purchasing, in the market or through private transactions, shares of the seller for a specified period of time—generally two to five years. This agreement of the buyer is sometimes more broadly drafted to preclude initiation or participation in

The buyer will often request that the standstill should permit the right to purchase a toehold interest in the target, up to 4.99 percent of its shares outstanding—just below the five percent threshold for reporting the equity stake to the SEC as required by law.2 This is both an expression of serious interest to the target, and a means of hedging against the loss of the target to another buyer willing to pay a higher price. Profits on toehold positions are sometimes justified as compensation for expenses incurred in due diligence and deal development.

Generally, the standstill is most relevant for public targets, whose shares are traded on an exchange. But the standstill could also be highly relevant for a privately owned target where the shareholders have divided into opposing groups with one group threatening to sell to the next available buyer.

The standstill agreement takes the form of a brief letter signed by the buyer and countersigned by the target. It is often signed early in the deal development process and often bundled with agreements about confidentiality, exclusivity, and termination.

Additional Discussions:

Governance Mechanisms afternative (in the context of alternative methods to transfer control over the corporation)

## Discussion of incentive compensation

Incentive Pay Format

# Discussion of classified boards

Classified Board -Board with multiple classes of directors

(lass I(3) 2020 elec

2.9. 9 board members — Class II(3) 2021

Class III (3) 2022 Alternative: Proxy fight -> buy stock & then attempt to raid ( shureholder meeting) the board

Board of Directors

[ Unitary vs. Classified Board]

Aclass

(one class only elected each year)

(elected annually) use of MRGC - pro-forma valuation (for potential deal scenarios)

Bloombers

Buyp - complete dal detail + timeline

For MA -> for the entire market HP/Company mandatory

Contail A ports

For 3 case studies

Seagate MAA Juta

M& A Regulation

### **SCENARIO I CALCULATIONS**

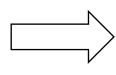
Scenario 1: #6 and #10 merge					
HHI Indexes before the contemplated transaction					
		Based on Revenues			
	Revenues	% Market Share	(Market Share) <sup>2</sup>		
Market Players					
1	100	18.2	330.6		
2	90	16.4	267.8		
3	80	14.5	211.6		
4	70	12.7	162.0		
5	60	10.9	119.0		
6	50	9.1	82.6		
7	40	7.3	52.9		
8	30	5.5	29.8		
9	20	3.6	13.2		
10	10	1.8	3.3		
Total	550	100.0	1272.7		



HH < 1,800, review by FTC unlikely

### **SCENARIO II CALCULATIONS**

Scenario 2: #1 and #2 merge					
HHI Indexes before the contemplated transaction					
	Based on Revenues				
	Revenues	% Market Share	(Market Share)2		
Market Players					
1	100	18.2	330.6		
2	90	16.4	267.8		
3	80	14.5	211.6		
4	70	12.7	162.0		
5	60	10.9	119.0		
6	50	9.1	82.6		
7	40	7.3	52.9		
8	30	5.5	29.8		
9	20	3.6	13.2		
10	10	1.8	3.3		
Total	550	100.0	1272.7		



HHI Indexes after the	IHI Indexes after the contemplated transaction			
		Based on Revenues		
		Revenues	% Market Share	(Market Share)2
Market Player	rs .			
Newco (=#1	+#2)	190	34.5	1193.4
3		80	14.5	211.6
4		70	12.7	162.0
5		60	10.9	119.0
6		50	9.1	82.6
7		40	7.3	52.9
8		30	5.5	29.8
9		20	3.6	13.2
10		10	1.8	3.3
Total		550	100.0	1867.8

HHI > 1,800, review by FTC very likely

## M&A Regulation & Defenses

Auti-trust regulation follows a process to determine the effect of the merger on competition:

2) HHT is used to determine the level of market concentration.

HerfindahlHirschman

Index (HHT)

An important aspect of

cross- % DQB elastraity = % DPA An important aspect of

the review is the definition

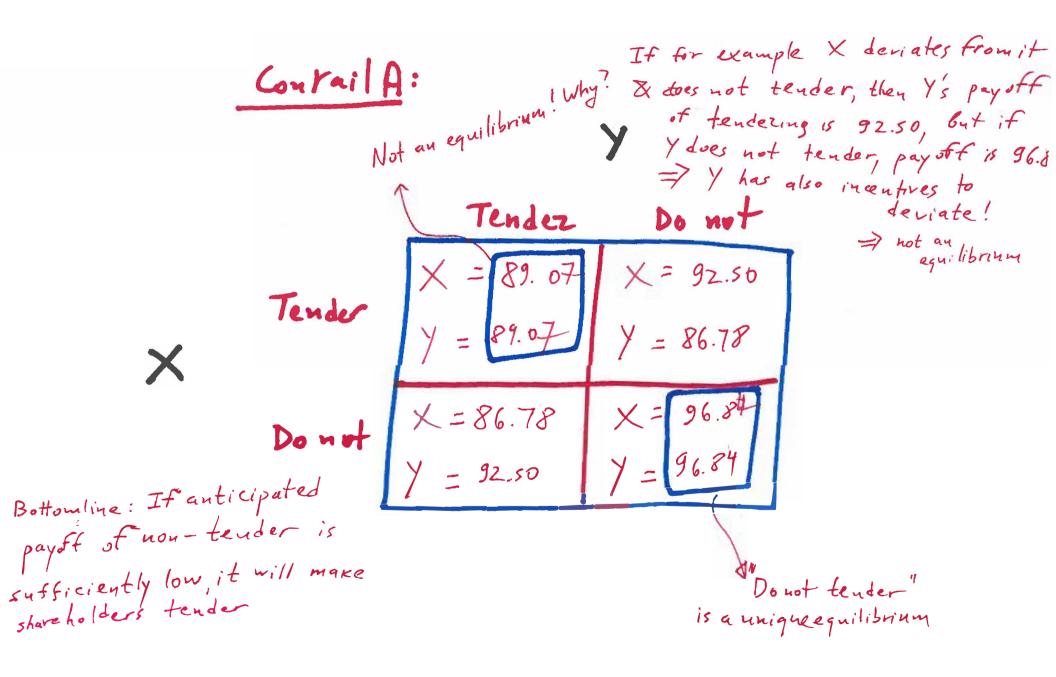
of the market. If

cross-elasticity > 1 =>

convergent (i.e. similar)

market

## Contail A Case Discussions



## Conrail A:

Enterprise Value = Total Firm Value

- Cash

(Non-operating)

we can think of enterprise value as the net acquisition cost of the firm

MRGC -> function in Bloomberg to retrieve the merger calculator Two-way table in Excel - robustness

Important to value cost savings & revenue enhancements w/ different discount rates

WACC = 14.18 %

CSX-CONRAIL

Why 40% in tender offer?

 $40\% \times 90.5 = 36.2 \text{ m}$   $\frac{\text{Lockup op fion}}{\text{Cockup op fion}} = 15.96 \text{ m}$   $\frac{\text{Cockup op fion}}{\text{Total}} = (90.5 + 15.96) = 106.46$ 

~ 49%. + 1.01. From management Discussion of Convail Case

State - Autitakeovez Provisions &

Mezger Contract Auti-takeover

Provisions

Two-tiered offer

first { - acquisition of up to 10% (due to poison pill)
stage { - acquisition of up to 20% (due to fair price law in PA)
second { freeze-out merger (stock-For-stock)
stage

Lock-up Option

Break-up Fee Poison Pill

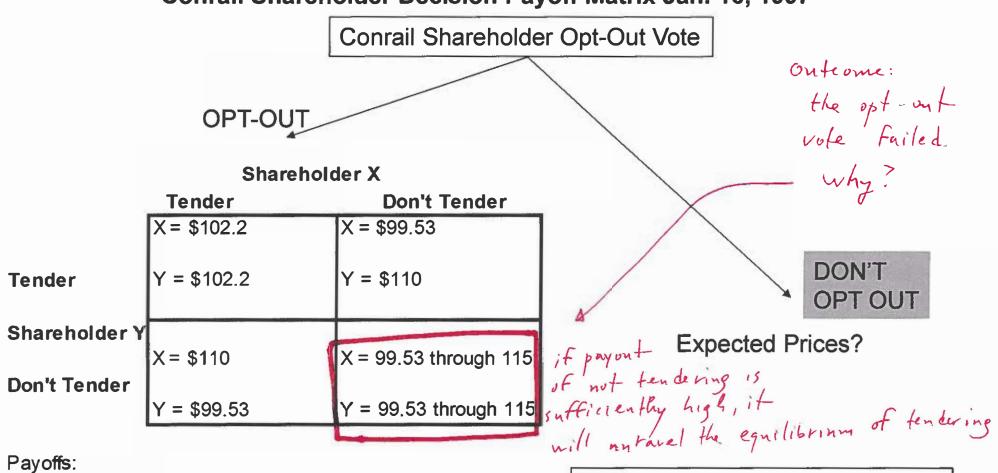
### Discussion of Conrail B

Valuation of Conrail in the anction:

- include squeegies
- include opportunity cost of failing to acquire contail
- (for Norfolk Southern) include also value of break-up fee & value of "lock-up" warmab to CSX

## To Opt-Out or Not?

Conrail Shareholder Decision Payoff Matrix Jan. 16, 1997



Front-end	\$110.00		(cash)
Back-end	\$99.53	=1.856*45	(ex. ratio * CSX price)
			(preferred stock)
Blended Value	\$102.16	=25%*110	(front-end cash offer)
	+	74.7%*99.5	(back-end stock swap)

Note: Front-end / back-end offers 25.3%/74.7% (not 40%/60%) after first stage of front-end completed.

### Make-up Quiz #8 (Week #7) for FIN 5372

Question #1 (1 pts)

(Essery Question #1 relates to the HBS case to be discussed in class, ConRail Acquisition-Part A; please target response of about 100 words)

Why does CSX want to buy Conrail? How much should CSX be willing to pay for its cost swings, reduction of assets enhancement of revenue, Question #2 (1 pts)

regulatory shock adjustment \$ \$97-\$1 (Essay Question #1 relates to the HBS case to be discussed in class. ConRail Acquisition-Part A; please turget

Question #2 (1 pts)

response of about 100 words) Why did CSX make a two-riered offer, i.e., from the bidder's point of view, what are the advantages of a two-tiered offer? What effect does this structure have on the transaction? coercive offer (back-end of offer is worse than

Question #3 (1 pts)

(Essay Question #1 relates to the HBS case to be discussed in class, ConRail Acquisition Part B; please turget response of about 100 words)

Why did Norfolk Southern make a hostile bid for Conrail? In a bidding war for Conrail, who should

be willing to pay more, Norfolk Southern or CSX?

— significant complementarity (revenue enhancement)

Question #4 (0.5 pts)

— dofensive motivation Question #4 (0.5 pts)

Essay Question #1 relates to the HBS case to be discussed in class, ConRail Acquisition Part B; please target response of about 100 words)

As a Conrail shareholder, would you tender your shares to CSX at \$92.50 in the first-stage offer? Would you vote to opt-out of the Pennsylvania antitakeover statute?

Question #5 (0.5 pts)

Business combination state statutes provisions preclude the sale of assets for a specific period following the buyout, thereby inhibiting financing of purchase price.

A. True

B. False

Question #6 (0.5 pts)

The Hart-Scott-Rodino Act provides for mandatory filing with the Federal Trade Commission if a merger or an acquisition of a certain size is agreed upon; it further anticipates 30 day waiting period before transaction can be completed.

A. True

B. False

Question #7 (0.5 pts)

Elasticity tests ("5% rule") is an alternative measure used to determine if merged firm has the power to control prices.

A. True

B. False