M&A In Focus: Don't Forget to Tell Shareholders How We Got Here

Shareholder buy-in can make or break your transaction, a detailed process is imperative for your success.

Transactions are often questioned by shareholders for any number of reasons. Investors may disagree with valuation, question the long-term strategy, or disapprove of the consideration's structure. But there is one tool above all else that can help get a transaction across the finish line - process.

Disclosing a thorough process can convert skeptics

Take Detour Gold's recent sale to Kirkland Lake Gold, which closed in January as an example. Detour Gold, a mid-cap, single-asset gold producer in Ontario, Canada agreed to be acquired by Kirkland Lake Gold, a multi-asset gold producer at a premium to its three-year high. Detour had to build strong consensus from shareholders to get the deal approved, as it had a high approval hurdle (two-thirds of votes cast) and a 10% dissent rights clause, which gave the buyer the option to walk away if that threshold was reached. Upon announcement, some large Detour shareholders agreed with the rationale for the combination but voiced opposition to the deal terms. This problem was underscored by Kirkland's 17.9% decline over the following two trading sessions, which reduced the offer price while also highlighting the hurdles that Kirkland faced in convincing its own shareholders.

The single biggest objection to the transaction with Kirkland from Detour shareholders was valuation. Many shareholders were bullish on the direction of gold prices and felt Detour shares provided significant leverage to the move in the underlying commodity. As a result, some shareholders expressed disappointment with the valuation despite the offer price reflecting a 24% premium to the unaffected price, which itself was close to a three-year high. Shareholders communicated that the direction of gold combined with operational guidance provided by the previous management team argued for significantly higher net asset valuation for Detour's operation and that further price discovery combined with continuing as a single asset producer until an adequate offer came along was the best option. As these issues mounted, the shares began trading above the implied offer price, reflecting investors' expectations of either an amendment to the original deal or the emergence of another bidder.

While the disagreement between shareholders and management first seemed insurmountable, the objections dissipated as investors were able to observe how comprehensive the board's process was in evaluating options and potential transaction partners. Over the course of the second half of 2019, the board's dedicated Special Committee and management left no stone unturned as they sought to unlock shareholder value through improving operations and cash generation all the while engaging with 15 interested transaction partners. The company spoke with six potential acquirers, including Kirkland, five potential merger partners, and four entities that were interested in selling themselves

or their assets to Detour, and all of this follows a similar strategic review process in 2018 when 12 counterparties had initiated engagement.

Investors were able to clearly see the board's thorough review process as laid out in the proxy statement, highlighting how multiple parties had an opportunity to review the asset over the course of two years. Once this was understood, arguments for higher valuation disappeared. As a result, 86% of shareholder votes cast supported the transaction, including several vocal shareholders who were initially opposed.

Lack of Process (or Lack of its Disclosure) Can Derail a Deal

Rowan Companies' merger with Ensco provides an example of how a sales process that is not thoroughly described can derail a transaction. Like Detour Gold, Rowan asked its shareholders to approve an equity transaction with Ensco. However, in addition to not running a formal sales process, Rowan provided few details on its engagement with other parties. The few details that were provided indicated that Rowan's board appeared to have allowed the company's CEO to lead the merger negotiations, which led to an agreement that he would be appointed CEO of the combined entity and caused some shareholders to question the quality of the sales process. The lack of details resulted in growing speculation that maximizing shareholder value was not the primary concern in the agreement.

After receiving significant market criticism, the board issued a press release that provided additional details about the sales process. Chairman William Albrecht stated that the board conducted a "thorough, multi-year review of alternatives" and held "extensive strategic dialogue and negotiations with 10 credible parties," emphasizing that it was the board, not the CEO, that was leading the strategic review and driving negotiations. Albrecht pointed out that he engaged directly with Ensco's Chairman Paul Rowsey regarding governance matters, including the CEO position and compensation, and that Rowan's CEO did not participate in those discussions.

Rowan shareholders did finally approve the transaction after Ensco improved the exchange ratio, but the limited level of disclosure in the initial proxy elevated shareholder concerns that value was not being maximized. While the additional details released after the fact highlighted a process that was thorough and free of conflicts of interest, early transparency would have mitigated criticism and allowed for a more efficient approval process.

A Detailed Process is Imperative

Both Detour and Rowan had sales processes that were driven by the board and aimed to maximize shareholder value. But the difference in how their respective processes were communicated played a significant role in how shareholders perceived the transactions. Detour's proxy statement laid out a comprehensive process that reflected active board leadership and clearly communicated a robust systematic attempt to realize as much shareholder value as possible. Rowan, however, initially provided few details to shareholders, even though their strategic review was a multi-year process that spoke to several counterparties. By leaving out those details, Rowan's shareholders were initially left with the impression that an adequate price discovery process was neglected.

In any given transaction, including non-contested situations, it is inevitable that some shareholders will question whether they are receiving fair value for their shares. Disclosing as many pertinent details as possible in the proxy statement can help alleviate shareholder concerns and feel confident that its board has maximized value.

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