M&A Trends, Transaction Pitfalls and More

A Conversation with Cristiano Guerra, Managing Director at ISS

In early March 2020, FTI Consulting's Corporate Governance & Activism team attended the 32nd Annual Tulane Corporate Law Institute to gather with the world's leading M&A, corporate, and securities law experts. Practice lead Rodolfo Araujo, CFA sat down with Cristiano Guerra, Managing Director and Head of Special Situations Research at ISS, to discuss 2020 M&A trends, shareholder engagement, and the common mistakes companies make during the transaction process.

Rodolfo: What are the trends you are seeing emerge in 2020 so far?

Cristiano: M&A activism was a clear trend in 2019, compensating for a slightly lower number of contested director elections going to a vote. This carried over into 2020, with three contested take-privates (Hudson's Bay, Instructure, and Pattern Energy) through early March.

Overall, the median market cap of targeted companies continued to increase, though that has been due in part to rising valuations. Regardless, when it comes to targeting board seats, target size is no longer an obstacle, particularly for the well-established activist firms. The barrier to entry in activism is also largely gone, which has allowed several investors to launch first-time campaigns.

The 2020 proxy season will obviously be shaped by coronavirus; activists might not abandon planned campaigns altogether but could delay them until the full impact of the pandemic becomes more apparent.

Rodolfo: How do you approach contested M&A transactions? Are there specific questions that you'd like to see answered?

Cristiano: Mergers are often a pivotal point in a company's history, given that they serve as one of the few opportunities for shareholders to directly express their support for, or frustration with, management's strategy and the board's decisionmaking process. Within that context, the main question we try to address - through a long-term lens - is whether the proposed transaction represents the best available alternative for shareholders.

As is the case with our framework for contested board elections, the onus is on the dissident challenging the transaction to articulate what may be wrong with the deal; more importantly, however, the dissident must also present a compelling argument that a better alternative exists.

Rodolfo: What role does shareholder engagement play in your analysis of M&A transactions?

Cristiano: We make every effort to consider the views of well-informed shareholders. We have a strong team of nine SSR analysts (six in the US and three in Europe) with diverse backgrounds and skillsets. However, we are primarily generalists. In that sense, dialogue with knowledgeable investors, who may have followed an industry or a specific company over several years, can be particularly informative. The main benefit of these conversations is that they help us frame the issues and questions we need to address when we engage with merging companies or the investors opposing these transactions – these are the discussions that ultimately drive our recommendations.

Rodolfo: Have you observed any "common" mistakes that put transactions in jeopardy?

Cristiano: I would argue that our support rate for mergers easily exceeds the percentage of deals that ultimately drive long-term value for shareholders. Given this conservative opposition rate, it's hard to say that we come across "common" mistakes; many times, the concerns that yield negative recommendations are rooted in potential conflicts of interest or a suboptimal process. In situations where that is not the case, it is still critical for companies to have a consistent narrative that clearly articulates the strategic merits of a transaction. Robust engagement with shareholders often goes a long way towards addressing, or avoiding, potential problems.

Rodolfo: How do you assess transactions where investors support the strategy but disagree on valuation?

Cristiano: The last thing we want is to serve as a vector for "bumpitrage." One of the key considerations in this regard is whether the disagreement on price is based on a short-term assessment, rather than a long-term view.

Disagreements over price are often magnified by the lack of a compelling strategic rationale or, as indicated in your previous question, inconsistencies in a company's communications strategy. When that is not the case – and the strategic rationale is self-evident or well-articulated by the board – a negative recommendation would only be based on the notion that a superior alternative is highly likely.

**[The term 'bumpitrage' refers to the act of buying shares in a company subject to a takeover after the announcement and then threatening to obstruct the deal unless terms are improved.]*

Rodolfo: Does the form of the transaction's consideration impact your analysis?

Cristiano: The form of the consideration matters, especially in relation to the broader financial environment. In periods of uncertainty, like we are currently experiencing, the certainty of value inherent in cash is extremely relevant. However, there are times and situations where the risk/reward equation will suggest that cash does not necessarily win out.

Rodolfo: Do you apply a different framework when analyzing merger-of-equals transactions (MOEs)?

Cristiano: In the absence of a premium to either side, most of the economic incentive for shareholders in a MOE comes from the synergies expected from the combination, which can carry a relatively high level of execution risk. As a result, we apply a higher degree of scrutiny to these transactions compared to deals that result in a change in control.

We will take a close look at the sales process, particularly in situations where the deal was the result of exclusive negotiations, as this can leave shareholders with limited market-based evidence that the deal they are being asked to approve represents the best available alternative. We will also analyze these transactions within the context of the broader industry sector. Often, it boils down to whether companies are truly being valued as "equals" in a MOE, and we will look at whether there were factors on either side that may have contributed to an uneven split.

Rodolfo: Over the last three years, the number of funds employing activist strategies has increased, but proxy contests have declined - why?

Cristiano: The settlement process has become very fine-tuned in recent years, which has greatly reduced the number of contests that go all the way to a vote. The bigger question is whether that will continue to be the case as we begin to climb out of this recent market downturn.

Meet the Corporate Governance & Activism Team

Rodolfo Araujo, CFA *serves as the head of the Corporate Governance and Activism practice. Mr. Araujo advises companies of all sizes on merger & acquisitions, contested proxy campaigns, and ESG issues. Prior to FTI, Mr. Araujo was a Vice President in ISS' Special Situations Research Group where he advised on approximately 100 contested situations.*

Paul Massoud, CFA *has eleven years of sell-side equity research experience, with demonstrated expertise in investor communications, relative and absolute valuation, corporate finance, and transaction due diligence. Mr. Massoud advises companies of all sizes on merger & acquisitions and contested proxy campaigns.*

Kosmas Papadopoulos, CFA *brings more than a decade's experience in corporate governance research and proxy voting, Kosmas Papadopoulos advises companies through complex ESG issues and provide ongoing counsel as they interact with actively managed funds, index funds, and proxy advisors.*

RODOLFO ARAUJO, CFA
Senior Managing Director and
Head of Corporate Governance & Activism
rodolfo.araujo@fticonsulting.com

PAUL MASSOUD, CFA
Managing Director
paul.massoud@fticonsulting.com

KOSMAS PAPADOPOULOS, CFA
Senior Director
kosmas.papadopoulos@fticonsulting.com

FTI CONSULTING™