

The potential impact of changes to the Takeover Code

The UK Takeover Panel is currently considering changes to the Takeover Code, which could have a significant impact on private equity activity. In particular, the Panel is proposing to name potential bidders in the first announcement, as well as giving potential bidders just four weeks to announce their firm intention to bid. The Panel is also considering changes to break fees and disclosure, including the bidder’s deal financing arrangements. This note details the results from a short survey of BVCA members about the potential impact of these changes to the Code.

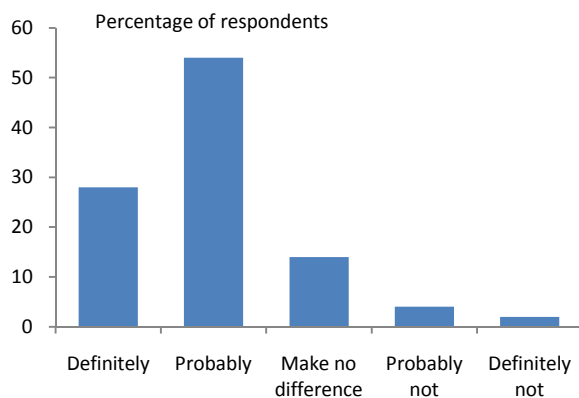
Background to proposed changes to the Takeover Code

In June 2010, the UK Takeover Panel published a public consultation paper that discussed a wide range of possible amendments to the Takeover Code. After receiving 97 responses, the Panel subsequently published its response to the consultation, setting out the Panel’s initial conclusions. While further consultations are planned before any changes to the Takeover Code are implemented, the BVCA’s Legal and Technical Committee (L&TC) thought it would be useful to gauge BVCA members’ views on the potential changes to the Code that the Takeover Panel are considering. As such, the BVCA Research Team launched a short online survey about these changes in December 2010, which was sent to Investment Managers and other professionals involved in buyouts. The survey closed on 14 January 2011, having received 51 responses; the survey questions are available in the Annex.

Naming potential bidders in first announcements & timing of bids

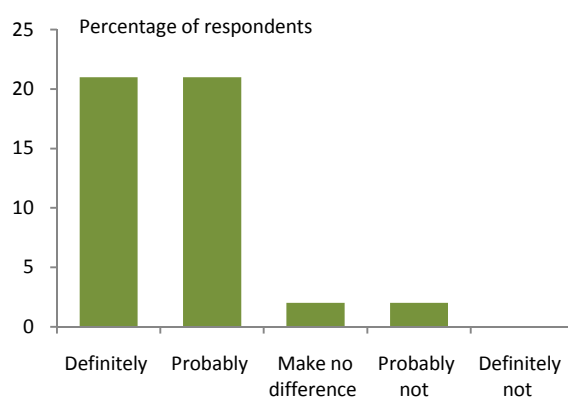
One of the changes the Panel is considering is that potential bidders are named in the first announcement of a possible bid. Furthermore, potential bidders may be given as little as 4 weeks to announce their firm intention to make a bid (or make a binding announcement that it does not intend to bid). The first two survey questions addressed this issue, asking respondents whether naming bidders and the four-week “put up or shut up” period could dissuade them from bidding. Results are shown in Charts 1 and 2 – the clear consensus among respondents is that these changes would probably dissuade them from bidding, particularly the 4-week bid period. Reducing the number of potential bids is unlikely to be in shareholders’ interests, and could entrench under-performing boards.

Chart 1: Would naming bidders put off potential bids?



Source: BVCA.

Chart 2: Would a 4-week period put off bids?



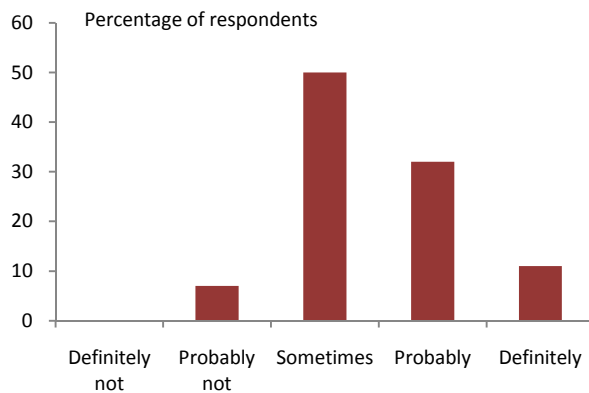
Source: BVCA.

The survey also asked respondents how long, in their experience, it typically took to organise a bid for a public company, including setting up bank finance, necessary due diligence, etc. Over 90% of respondents thought that it took at least 6 weeks to complete these activities, with 48% stating that it would take longer than 8 weeks. The 4-week period is therefore too short. The Takeover Panel has said it will consider extensions to the four-week period, but only if the target company agrees, creating significant uncertainty for the bidder; as such, this mechanism could limit bids, again impacting on shareholder value.

Inducement fees & disclosure arrangements

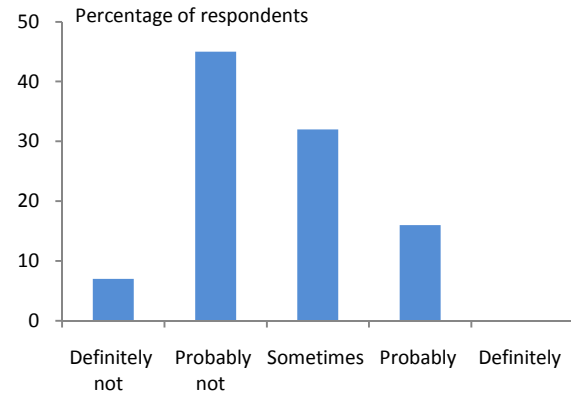
The Takeover Panel has also announced its intention to ban inducement or break fees, which allow initial bidders to recover some of their costs (eg due diligence) if a rival bid is eventually preferred. These fees are currently capped at 1% of the offer price. The survey also asked respondents about the impact of these fees, and their potential prohibition. Results are shown in Charts 3 and 4 – these suggest that, while the absence of these fees could dissuade potential bidders from making an initial offer, they do not have a major impact on the decision of subsequent bidders to make a rival offer.

Chart 3: Would banning break fees prevent initial bids?



Source: BVCA.

Chart 4: Do 1% break fees prevent you bidding?



Source: BVCA.

Finally, the Panel is also planning to require much greater disclosure from bidders. This would include the bidder’s financing arrangements for the deal, a breakdown of deal costs, the financial position of the bidder, and possibly a pro forma balance sheet of the combined bidder/target group. Over 40% of survey respondents thought that these requirements would act as a significant deterrent to them making a bid, with almost 50% stating that they would act as a minor cost and deterrent. Such measures could also therefore limit the number of bids, implying that shareholders may not get the maximum possible returns from any takeover deal.

Conclusions

While it is sensible to review the UK Takeover Code on a periodic basis, the results of our survey suggest that overwhelming impact of the Takeover Panel’s proposed changes will be to dissuade certain bidders altogether. Unfortunately, this will strengthen the hand of under-performing boards, as there will be less market discipline to regulate their performance. This is clearly not in shareholders’ interests. The changes to the Code could also inhibit mergers & acquisitions activity more broadly, potentially affecting productivity, tax receipts, and the UK’s ability to build world-leading organisations. At a time when the onus is on the private sector driving growth, these changes could have far-reaching effects.

If you have any questions or comments, please contact Colin Ellis: cellis@bvca.co.uk

Annex: List of survey questions

1. Could a requirement that potential bidders be named in the first announcement prevent your firm with proceeding with a bid, if it had not yet been able to do sufficient due diligence on the target?
Definitely / Probably / Make no difference / Probably not / Definitely not
2. Could a four-week period potentially put your firm off making a bid for a firm (eg if that was not long enough to arrange debt finance and do due diligence for your firm and its banks)?
Definitely / Probably / Make no difference / Probably not / Definitely not
3. In your experience, how long does it typically take to organise a bid for a public company, including arranging bank finance, due diligence, etc. ?
Up to 4 weeks / 4-6 weeks / 6-8 weeks / Longer than 8 weeks
4. Would the absence of inducement fees prevent you from making an initial offer for a potential target company?
Definitely not / Probably not / Sometimes / Probably / Definitely
5. Would the existence of an inducement fee (capped at 1%) between the target and another bidder prevent you from making a rival bid?
Definitely not / Probably not / Sometimes / Probably / Definitely
6. For all bids, whether in cash or not, the Panel is planning to require much greater disclosure. This includes the bidder's deal financing arrangements (including a break-down of deal costs), the financial position of the bidder, and possibly a pro forma balance sheet of the combined bidder/target group.

In your opinion, what impact would this type of requirement have on a potential bidder?
Would act as a significant deterrent to making a bid / Minor cost & deterrent to making a bid / No significant impact