Private equity bidders: Barbarians or best friends?

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The deal value of private equity merger and takeover activity has achieved unprecedented growth in the last couple of years, in Australia and globally. Private equity deals are not a new feature of the market; however, such deals have been subject to increased academic, professional and policy interest. This study examines the particular features of 15 major deals involving listed company "targets" and provides evidence – based on a comparison with a benchmark sample – to demonstrate the role that private equity plays in the market for corporate control. The objective of this study was to assess the friendliness of private equity bids. Based on the indicia compiled, lower bid premiums, the presence of break fees and the intention to retain senior management are compellingly different for private equity bids than for the comparative sample of bids. Using these several characteristics of "friendliness", the authors show that private equity deals are generally friendly in nature, consistent with industry rhetoric, but perhaps inconsistent with the popular belief that private equity bidders are the "barbarians at the gate".

INTRODUCTION

The deal value of the so-called private equity merger and takeover activity has achieved unprecedented growth in the last couple of years, both in Australia[1] and globally.[2] Private equity deals are not a new feature of the market; however, such deals have been subject to increased academic,[3] professional[4] and policy interest,[5] primarily due to the size and profile of some of the transactions completed or proposed. This study provides some insight into private equity transactions in Australia by investigating their particular features. It examines 15 major deals during 2005-2007 involving listed company "targets" and provides evidence to demonstrate the role that private equity plays in the market for corporate control in Australia. Private equity bids are often characterised as friendly in nature in the literature.[6] The objective of this study was to assess the friendliness of private equity bids. Using several indicia of "friendliness", the authors are able to show that private equity deals are generally friendly in nature, consistent with industry rhetoric, but perhaps inconsistent with popular belief.[7] The evidence provided is based on a comparison between the private equity deals and a benchmarked sample of deals.

The 15 bids examined are those merger or takeover transactions involving private equity bidders between 2005 and 2007, as disclosed on the database Connect 4. The sample period concludes at 2007

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1 Reserve Bank of Australia, *Financial Stability Review* (March 2007).

2 OECD, *The Role of Private Pools of Capital in Corporate Governance: Summary and Main Findings*, http://www.oecd.org/daf/corporate-affairs viewed 25 November 2010.

3 Recent academic literature includes Hruby M, "Private Equity Bids: Managing Conflicts of Interest When Public Companies Go Private" (2008) 26 C&SLJ 304; Chaung YB, "Issues in Private Equity Buyouts: Are Private Equity Firms within the Ambit of the TPA?" (2007) 25 C&SLJ 505 and other articles referred to herein.

4 Austin R and Tuch A (eds), *Private Equity and Corporate Control Transactions* (University of Sydney, 2008).

5 Takeovers Panel, *Insider Participation in Control Transactions, Guidance Note 19* (2007).

6 Chaung YB, "The Lure of Private Equity: Financial Arrangements with Target Directors" (2010) 28 C&SLJ 180.

7 For example, the popularist tag line "Barbarians at the gate". This is discussed later.

simply because it was not possible to identify any private equity deals on Connect 4 for the year 2008 to mid 2009. Data published by the Australian Private Equity and Venture Capital Association (AVCAL) indicate a sharp decline in private equity fundraising during 2009.[8] Recent articles in the Australian financial press acknowledge that there has been a slowdown in the financing market for private equity deals since the "boom" times of 2007, but report that the deal situation is improving.[9] Going forward, this study informs the market as to the types of deals that private equity funding prefers. In "profiling" the targets of private equity investment over the sample period, the authors identify first-order and second-order indicia of friendliness, which characterise and differentiate private equity acquisitions from other market deals. The first-order criteria relate to definitive features of the bid, usually within the bidder's control, such as choice of deal structure, consideration and bid premium, and intention regarding incumbent management. This also includes the bid response, which is not necessarily controlled by the bidder, but has a distinct observable outcome – such as the target board recommendation and the use of independent valuation reports. The second-order criteria are perhaps more speculative, relating to qualities of the target firm that are observable to all market participants, but for which evidence is provided as to private equity investment preferences. Characteristics examined here include the brand status of the target, its ownership concentration and firm size. These results contribute to the ongoing regulatory debate about the role of private equity investment in the securities market.

The article is structured as follows. The next section describes particular characteristics of private equity takeovers that indicate there are some unique features relating to the acquirer's priorities and imperatives. The authors establish that the primary criterion of investigation is "deal friendliness" and suggest ways to measure it. The private equity deal sample used to illustrate this study is then described, as well as the other data employed in the study. This is followed by the results of the investigation of private equity deals' friendliness. Based on the indicia compiled, it was found that lower bid premiums, the presence of break fees and the intention to retain senior management are compellingly different for private equity bids. Private equity bids are further profiled with a case study example of a successful bid. The conclusion summarises the results, but also looks to the matters not explained by the current samples (eg the role of expert reports) and suggests further research.

PRIVATE EQUITY DEALS

The structure of the deal

The market for corporate control is well developed in Australia and incorporates transactions such as mergers, schemes, takeovers and buyouts, with these terms often used interchangeably. There is no precise definition of private equity, with the term generally used to describe two types of investment. The first is often known as "venture capital", with investors providing equity funding to small and relatively high-risk companies with strong growth potential. The second, which is used in the context of this study, refers to the acquisition of a public company with the intention of taking it "private", delisting the company from the securities exchange. Private equity deals in the past have also been referred to as leveraged buyouts (LBOs), due to reliance on debt finance.[10] Further, private equity has been associated with management buyouts (MBOs), where incumbent management persist post-takeover.[11] Management cooperation allows the incumbent management to be part of the buyout, holding a portion of equity while continuing to run the company.

Typically, the term "private equity" refers to an investment fund. There are a number of features specific to private equity funds that typify them and the deals in which they engage. The funds are

[8] AVCAL, *2009 Yearbook: Australian Private Equity and Venture Capital Activity Report – Executive Summary* (2009), http://www.avcal.com.au/sites/default/files/general-files/AVCAL_ActivityReport_Nov2009.pdf viewed 25 November 2010.

[9] See eg Freed J and Thompson S, "Private Equity Prepared to Start Small", *Australian Financial Review* (5 March 2010) p 26; Boyd T, "Private Equity in the Pink", *Australian Financial Review* (20 July 2010) p 64; Main A, "Private Equity Makes its Case", *The Australian* (7 April 2010) p 9.

[10] D'Angelo N, "Private Equity Investing by Financial Institutions: Navigating Hidden Reefs in Treacherous Waters" (2003) 31 ABLR 311.

[11] Hruby, n 3.

structured as limited partnerships managed by partners who act as general partners but contribute only a very small portion of the investment funds. The primary investors, referred to as limited partners, do not participate in the management of the partnership but benefit from limited liability. Fund managers (the general partners) receive a management fee based on the size of the fund and also a share in the capital gains delivered.

The investment capital raised by private equity funds comes from "sophisticated" investors. These investors are institutional investors, such as pension funds, endowment funds and insurance companies, but also include very high net-worth individuals. These investors undertake comprehensive due diligence on the fund managers and thoroughly review the fund documentation, often utilising independent expert advisers. Private equity funds are usually established for a fixed period of time. This is governed by legal documentation stipulating that at expiry of the term, the investments of the fund must be realised and the capital returned to the investors unless an extension of the fund is agreed upon by the partners. In this sense, private equity funds offer very little in terms of intermediate liquidity.

Perhaps the most prominent feature of private equity funds is the level of debt employed, which magnifies the buying power of the funds and provides for higher rates of return on invested capital. Typically, the general partners play an advisory role, sitting on the board and keeping fully aware of the company's situation, but employing specialist management to provide additional expertise in specific areas.

Given the fixed duration of private equity funds, the investments are managed with a beneficial sale in mind. In this regard, the three main exit strategies are:

- taking the business public again with a float – this will typically be treated as a new listing, the same as an initial public offering (IPO);
- selling the company in a "trade sale" to a corporation; or
- selling the investment to another private equity firm in a "secondary sale".

Since an IPO is the most commonly used exit mechanism, private equity firms like to operate in environments with a healthy exchange-traded market.

Austin and Tuch[12] recognised that there are a number of distinctive characteristics of private equity, and their observations that relate to takeover transactions include:

- the targeting of poorly managed businesses;
- high levels of debt funding from third party lenders;
- high gearing post-acquisition;
- medium- to long-term investment strategy (say three to seven years) for resale; and
- control of the acquired businesses and the injection of management disciplines to achieve aggressive business plans.

Private equity and the deal "image"

The topical nature of private equity in recent times prompts a fresh look at these deals. In the past, there were quite negative associations surrounding private equity/LBO type deals – in particular, the traditional association between private equity acquisitions and hostility. Private equity firms were dubbed "Barbarians at the gate" following the buyout of RJR Nabisco by the private equity firm Kohlberg Kravis Roberts,[13] and have consequently been associated with hostility. In recent times, the major Australian players have rejected the "barbarians" tag.[14] Cheffins and Armour[15] observed that

[12] Austin and Tuch, n 4, p 6.

[13] Burrough B and Helyar J, *Barbarians at the Gate: The Fall of RJR Nabisco* (Jonathan Cape, London, 1990).

[14] David F Jones, the Chair of AVCAL, stated that the "B" word is banned: "A Comment from the Private Equity Citadel" in Austin and Tuch, n 4, p 32.

[15] Cheffins B and Armour J, "The Eclipse of Private Equity" (2008) 33 *Delaware Journal of Corporate Law* 1.

private equity funds will usually opt to negotiate a friendly deal. Further, in Australia, Bednall argued that "in ninety-nine percent of cases, private equity firms will avoid a hostile bid".[16]

According to AVCAL, private equity aims for business turnaround, recovery and expansion. There are five factors that allow private equity to add value to businesses, factors which are said to be the hallmarks of private equity investment.[17] These factors are:

1. The foundation of private equity's ability to *add value is an alignment of interest between the owners and the management of the firm.* With all parties having a genuine stake in the business, there is a common focus on increasing the value of the investment.
2. The focus of private equity on value means that *long-term success is not sacrificed in the pursuit of short-term growth*. Private equity-backed companies can therefore invest in new products, businesses and employees without concern for short-term earnings effects.
3. The *detailed due diligence performed by private equity fund managers* is an important value-adding factor, with the thorough research and assessment conducted during the investment process providing insight into a business's strengths and weaknesses, both financial and non-financial, the dynamics of the industry in which it operates, its potential for growth, and the prerequisites for achieving this growth.
4. The private equity fund ensures that there is *appropriate planning for growth of the investment*. The insights from undertaking the due diligence allow the fund to develop with management a comprehensive long-term plan to increase the value of the business, a plan which typically stresses the importance of sales growth as well as cost efficiency, emphasises cash as much as earnings, focuses on a small number of essential performance metrics, and includes a capital expenditure program to ensure that the business has the plant and equipment necessary to meet its growth targets.
5. *Active stewardship* is a significant factor in adding value to investments, with performance metrics and progress against targets monitored closely so that any remedial measures can be implemented promptly. Decisions are made swiftly and on a timely basis, and plans and strategies of the firm are constantly reviewed to address changing market conditions.

Another major observation is that, compared to other targets, the private equity deals examined in this study are major, "iconic" brand names[18] in Australia. The attraction of the brand in a turnaround situation is understandable – but the risk to reputation is a challenge for the acquirer. This suggests a solid underlying business, but with that comes a high market profile and the potential for extra media scrutiny.

How has private equity managed to re-image itself in recent times? In this study, the three primary observations – that private equity avoids the appearance of hostility; that private equity prioritises the potential for successful turnaround and spin off; and that private equity targets iconic brands – combine to posit that, overall, private equity bidders are "friendly" participants in the market for corporate control. Hence, the objective of this study was to assess the friendliness of private equity bids, using several indicia of bid friendliness drawn from the bid features. The research design compared bid characteristics of private equity bids to other contemporaneous bids. In particular, in identifying the features of bid friendliness, the authors selected those indicia of friendliness that were controlled by the bidder and were disclosed in the bidder's statement. For example, the bidder controlled the price offered and other conditions and features of the bid. By identifying and collating these indicia of friendliness, this study provides evidence on the attributes of private equity bids and identifies the profiles of these private equity bids and the bid characteristics they prefer.

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[16] Bednall T, "Target Board's Duties: "No Shop" or "Go Shop"?" in Austin and Tuch, n 4, p 58.

[17] AVCAL website, http://www.avcal.com.au/news/details/policy-news/avcal-submission-to-senate-enquiry-appendix-4/351 viewed 4 April 2011.

[18] The marketing literature accepts the nomenclature that brands become "icons": Holt DB, *How Brands Become Icons* (Harvard University Business School Press, 2004). The current authors used the Interbrand surveys. Three of the private equity sample have been mentioned in the Interbrand Top 20 Australian Brands survey during the period 2002-2009. None of the control sample is found in the Interbrand survey: see http://www.interbrand.com viewed 25 November 2010.

BID FRIENDLINESS

Takeovers as managerial discipline

The regulation of takeovers in Australia rests on the notion that such deals are an integral part of the operation of the equity markets and the economy.[19] In particular, takeovers are recognised as a corporate governance mechanism – they operate as a discipline on managers who may be replaced by an acquirer who thinks they operationalise more effectively the target company's resources.[20] Jensen[21] asserted that takeovers occur because conditions require a restructure of corporate assets, and change is easier to achieve with new management. According to classic economics, the role of the market for corporate control in motivating, and subsequently disciplining, management "is crucial to understanding much of the rhetoric about the effects of hostile takeovers".[22] Traditionally then, disciplinary takeovers are perceived as hostile, as a threat to existing management.

Accordingly, bidders acquire underperforming targets. Evidence from the United States[23] consistently finds that hostile targets have poor performance prior to the bid. Performance is measured either as market returns or Tobins Q.[24] Australian studies[25] using earlier sample periods also found that targets underperform in the pre-bid period.

The classic takeovers literature also recognises a second broad reason for the acquisition – if there is some other gain to the bidder, broadly referred to as synergistic. Synergistic, or friendly, takeovers are where the target firm does not oppose the bid. Synergistic takeovers are said to be friendly in nature because management and the shareholders stand to benefit from integrating the two businesses.[26] This is generally taken to mean some operational type synergy, such as increased production capacity and efficiencies.[27]

What role do private equity bidders play in this market? According to the Reserve Bank of Australia (RBA), private equity transactions in the Australian market support the inefficient management hypothesis, and play an important role in ensuring an efficient and dynamic business sector.[28] Given that private equity acquirers are not part of a specific industry or product market, this supports the RBA view. It would not be as if private equity bidders seek to exploit efficiencies from horizontal or vertical mergers, for example. However, it may be a synergy in that the bidder recognises some element in the target's financial capacity, such as borrowing capacity (referred to as financial slack), that suits a particular turnaround and exit strategy. Chapple, Clarkson and King,[29] using a

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[19] Commonwealth of Australia, *CLERP Paper No 4, Proposals for Reform – Takeovers: Corporate Control: A Better Environment for Productive Investment* (1997), http://www.treasury.gov.au viewed 25 November 2010.

[20] Ford H, Austin R and Ramsay I, *Ford's Principles of Corporations Law* (Lexis Nexis, 2009) at [7.630].

[21] Jensen M, "Takeovers: Their Causes and Consequences" (1988) 2 *Journal of Economic Perspectives* 21.

[22] Jensen, n 21 at 23.

[23] Martin KJ and McConnell JJ, "Corporate Performance, Corporate Takeovers, and Management Turnover" (1991) 46 *Journal of Finance* 671; Morck R, Shleifer A and Vishny R, "Alternative Mechanisms for Corporate Control" (1989) 79 Amer Econ Rev 842.

[24] The Q ratio is calculated as the market value of a company divided by the replacement value of the company's assets. It is used as a measure of the company's performance, so a lower score (less than 1) indicates that the market value is less than the recorded value of the assets of the company. This suggests that the market may be undervaluing the company.

[25] Brown P and da Silva Rosa R, "Takeovers: Who Wins?" (1997) JASSA 2; Eddey P and Taylor S, "Directors' Recommendations on Takeover Bids and the Management of Earnings: Evidence from Australian Takeovers" (1999) 35 *Abacus* 29.

[26] Morck R, Schleifer A and Vishny R, "Characteristics of Targets of Hostile and Friendly Takeovers" in Auerbach AJ (ed), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press, Chicago, 1988).

[27] Ambrose BW and Megginson WL, "The Role of Asset Structure, Ownership Structure, and Takeover Defenses in Determining Acquisition Likelihood" (1992) 27 *Journal of Financial and Quantitative Analysis* 575.

[28] Reserve Bank of Australia, n 1.

[29] Chapple L, Clarkson P and King J, "Private Equity Bids in Australia: An Exploratory Study" (2010) 50 *Accounting and Finance* 79.

similar sample of private equity bids, found that private equity funds target firms that have greater financial slack and greater financial stability, compared to a sample of benchmark targets firms acquired by other corporate bidders.

Further, Austin[30] mentioned that the acquisitions are only made after a long process of due diligence and it is common for the deals to feature

- break fee and "no talk" undertakings obtained from the target board; and
- target executives being approached to join the bidding consortium.

Accordingly, are private equity bidders able to occupy an unusual place in the market, as a corporate governance disciplinary measure, but one characterised by cooperation and "friendliness"? This question is investigated below.

Indicia of bid friendliness: The bidder

To commence the examination of private equity bids, it is necessary to identify possible attributes of "friendliness". Accordingly, this study identifies several indicia of the friendliness of private equity bidders – that is, characteristics of the deal as constructed by the bidder and disclosed in the bidder's bid documents. This has not been mentioned so far in the legal commentary on private equity transactions. Table 1 sets out the indicia of bid friendliness and plausible ways this could be measured.

First, *bid premium* is used as the predominant measure of friendliness. The bid premium is the additional amount an acquirer offers above the pre-bid share price in a bid. It has long been argued that a higher bid premium is required in a hostile takeover attempt.[31] Indeed, this makes logical sense, as the conditions of a friendly takeover offer have likely been negotiated prior to making the formal bid. Therefore, given the theoretical literature and anecdotal evidence surrounding the friendliness of private equity bidders, bid premiums offered by private equity bidders are expected to be lower than bid premiums offered by other bidders.

Secondly, Austin[32] mentioned *break fees*. The presence of a break fee arrangement suggests due diligence and target board cooperation. A break fee is defined by the Takeovers Panel[33] as "consideration however payable by a target if specified events occur which prevent a bid from proceeding or cause it to fail". Generally, this is because the target shareholders decline the offer or fail to approve the merger, or the target receives a superior proposal from a rival bidder. These events will typically be outside the control of the bidder, but not necessarily of the target or its shareholders. A break fee is a deal protection device, negotiated with the target board prior to the bid.[34] The prevalence of break fees in Australian bids has increased in recent years.[35] However, Chapple et al[36] found that break fees in Australia (which are capped at 1% of the bid value)[37] are not associated with bid success. The presence of the break fee indicates target management commitment to the deal and they are used to induce bids where there is a high risk of failure. Accordingly, a bidder must be in a certain position to be able to negotiate a break fee into the transaction, and it is expected that private equity bidders are in a position to negotiate this part of the deal more often than other bidders.

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[30] Austin R, "An Introduction to Private Equity" in Austin and Tuch, n 4, pp 6-7.

[31] Franks J and Mayer C, "Hostile Takeovers and the Correction of Managerial Failure" (1996) 40 *Journal of Financial Economics* 163.

[32] Austin, n 30, pp 6-7.

[33] Takeovers Panel, *Lock-up Devices*, *Guidance Note 7* (February 2010).

[34] Mayanja J, "No-shop, No-talk and Break-up Fee Agreements in Merger and Takeover Transactions: The Case for a Fresh Regulatory Approach" (2002) 14 AJCL 1.

[35] Reichel D and Dyer B, "Developments in Break Fees" (2004) 22 C&SLJ 439.

[36] Chapple L, Christensen B and Clarkson P, "Termination Fees in a 'Bright Line' Jurisdiction" (2007) 47 *Accounting and Finance* 643. This is contrary to the findings eg in the United Kingdom, where break fees have been found statistically to correlate with bid success: Officer M, "Termination Fees in Mergers and Acquisitions" (2003) 69 *Journal of Financial Economics* 69.

[37] See Takeovers Panel, n 33 at [7.15].

TABLE 1 The indicia of friendliness

Characteristics	Description	Measure	Expected frequency for private equity bids
Panel A – Indicia of bid friendliness: the bidder			
Bid premium	The price offered above the pre-bid share price in order to succeed in a takeover offer	Dollar value	Lower value
Break fee	The target agrees to pay a break fee in the event that the bid does not proceed	Dichotomous: 1 if disclosed in bid document; zero otherwise	Higher occurrence
Pre-bid stake	The ownership interest held by the bidder prior to the bid	Frequency and percentage ownership	Lower occurrence; lower value
Senior management retention	The bidder's intention to retain existing board members and/or senior management of target	Dichotomous: 1 if disclosed in bid document; zero otherwise. Alternatively, scale measure to the quality of the stated retention	Higher occurrence and Higher occurrence of identified individuals
Scheme rather than takeover bid	The bidder structures the deal as a scheme of arrangement or as a Ch 6 takeover bid	Frequency	Higher occurrence
Panel B – Indicia of bid friendliness: the bid response			
Board of directors' recommendation: accept	The target board's mandated response to the bid	Frequency	Higher occurrence
Board of directors' recommendation: reject	The target board's mandated response to the bid	Frequency	Lower occurrence
Bid revision	Bidder revises the price offered during the course of the bid	Frequency	Lower occurrence
Independent expert report	Target board commissions an expert's report, either because it is mandatory, or because they choose to	Dichotomous: 1 if disclosed in bid document; zero otherwise. Alternatively, scale measure to the quality of the stated outcome	Lower occurrence of non-mandatory reports; Higher occurrence of mandatory reports; Higher occurrence of favourable outcome

Thirdly, the acquisition of a *pre-bid stake* in the target can be interpreted as a pre-emptive, aggressive move. In the United States, eg, researchers such as Betton, Eckbo and Thorburn[38] found that friendly bidders are inclined to refrain from a pre-bid stake (referred to as "toehold" in this literature) principally to avoid "toehold-induced" target resistance. In Australia, regulation is different, however, as bidders are constrained by the statutorily imposed ownership/interest threshold of 20%. That is, under s 606 of the *Corporations Act 2001* (Cth), any person who acquires an interest in voting shares in a listed Australian company (or an unlisted target with more than 50 members) such that their voting power in the target exceeds the threshold, is prevented from acquiring the voting shares, unless they are prepared to launch a full bid for the target. The thresholds for voting power are:

- for bidders who already have an interest in less than 20% of the shares, that bidder cannot exceed 20%;
- for bidders who already have between 20 and 90% of the target shares, they cannot acquire any more shares.

[38] Betton S, Eckbo B and Thorburn K, "Merger Negotiations and the Toehold Puzzle" (2009) 91 *Journal of Financial Economics* 158.

Using Australian data from prior decades, Eddey[39] and Henry[40] found that toehold has a positive impact on the success of a bid. Nevertheless, given the nature of the private equity bidder and the associations with friendliness, it is expected to be unusual for the private equity bidder to hold a significant run up pre-bid stake in the target.

Fourthly, the role of the target board management in facilitating the bid has been observed. The authors observed management's cooperation in providing access to information[41] and entering into break fee arrangements, "no shop" and "no talk" agreements.[42] If the private equity bidder secures management's future cooperation, then it is expected that *senior management retention* will be disclosed in the bid documents. Section 636(1)(c) of the *Corporations Act* requires the bidder to disclose its future intention regarding employees. It would be less likely that other market deals would feature disclosure relating to post-merger retention of senior management.

Fifthly, the *type of bid* is expected to be informative as to friendliness. The 15 private equity bids in the sample available from the Connect 4 database included both takeover bids (Ch 6 of the *Corporations Act*) and mergers or schemes of arrangements under Ch 5 of the *Corporations Act*. The Australian literature on schemes of arrangement suggests that schemes are a "friendlier" transaction due to the process involved. Section 411 of the *Corporations Act* provides that a compromise or arrangement will be binding on creditors, or members, where the scheme has been approved at a court-ordered meeting by a special majority of shareholders and also by the court. Although there is considerable formality, the scheme offers greater flexibility for capital restructure. The more consensual nature of a scheme of arrangement necessitates that target management work constructively with the bidder to ensure that the application to the court to request permission for the securities class meetings to be convened and arrangement is achieved. Consequently, it could be said that the process is less hostile.[43]

Indicia of friendliness: Bid response

Ultimately, the friendliness of the deal can also be categorised according to the main events that occur during the course of the bid. In the case of bids, this would typically include the nature of the target board's recommendation and its resistance strategies, and whether the bidder upwardly revises the bid.

Walkling[44] developed a model for bid success around a simple supply and demand schedule. In particular, variables that increase the supply of obtainable shares (such as increased bid premiums and increased bidder pre-bid ownership in the target) are shown to increase the probability of bid success; whereas variables that impede the tendering of shares (such as target management opposition) are shown to decrease the probability of success. Similarly, Henry[45] found that the outcomes of Australian takeovers are predominantly determined by takeover-specific factors, such as the target director's recommendation, the magnitude of bidding companies' pre-bid shareholdings, the magnitude of bid premiums offered and the existence of offer price revisions during takeover bids. These studies indicate that other variables can affect the perceived friendliness of the deal. Accordingly, these other variables are used to investigate the indicia of friendliness of private equity bidders, compared to other deals.

First, as to *board recommendation*, each target director must state, and provide reasons for their recommendation that the bid be accepted or not accepted: s 638(3) of the *Corporations Act*. According

[39] Eddey P, "Corporate Raiders and Takeover Targets" (1991) 18 *Journal of Business Finance and Accounting* 151.

[40] Henry D, "Corporate Governance and Ownership Structure of Target Companies and the Outcome of Takeovers" (2004) 12 *Pacific-Basin Finance Journal* 419.

[41] Bednall T, "Target Board's Duties: "No Shop" or "Go Shop"?" in Austin and Tuch, n 4; Hruby, n 3.

[42] Austin, n 30.

[43] Colla A, "Eliminating Minority Shareholdings – Recent Developments" (2001) 19 C&SLJ 7; Chapple L, Clarkson P and Hutchinson D, "To Scheme or Not to Scheme: Perceptions of Scheme of Arrangement Takeovers" (2009), http://www.ssrn.com/abstract=1444744 viewed 25 November 2010.

[44] Walkling R, "Predicting Offer Success: A Logistic Analysis" (1985) 20 *Journal of Financial and Quantitative Analysis* 20.

[45] Henry, n 40.

to Henry,[46] the reaction of the target management is the most important influence on the successful outcome of a takeover bid. If a majority of the target board recommend rejection of the bid, this is traditionally regarded as hostility. (This is also the definition of hostility used in the Connect 4 database.) For schemes, the target directors have a statutory obligation (s 411(3) of the *Corporations Act*) to prepare a comprehensive explanatory statement explaining the effect of the proposed scheme, including the rather open-ended requirement of disclosure of information material to the members or creditors making the decision on the scheme. It also includes the express requirement for a directors' recommendation, similar to s 638 of the *Corporations Act*.[47]

Secondly, the target board strategy of commissioning an *expert report* is one of the few legitimate "resistance" strategies implemented by the target board.[48] That is, an expert valuation report is typically used where the target board is hostile to the bid.[49] Although mandated independent experts' reports are required in the case of schemes[50] and bids[51] where there is some pre-bid stake or interlocked directors, target boards may choose to voluntarily commission a report:[52] Accordingly, one would expect that target companies receiving a private equity bid would be less likely than other targets to commission an independent expert's report. It is fair to say, though, that the market in Australia treats experts' reports with a high degree of cynicism. Bugeja[53] found a significant association between expert opinions and directors' recommendations – although this is stronger in the case of hostile takeovers.[54] However, whether the report is mandated or not, one would expect that, where the report is provided in a private equity bid, it would provide favourable opinion to the bid.

A *bid revision* is often considered as a measure of hostility because a revision is usually undertaken subsequent to unreceptive attempts at negotiation or a reject recommendation by the board of directors.[55] Accordingly, where a private equity bidder proceeds with a bid, it would be unlikely that it would need to offer an upward revision.

Summary of the indicia of friendliness

The research design aimed to compare private equity bids with other contemporaneous bids, according to the measures of friendliness described above. For each of these measures, it was expected that certain characteristics would be more or less frequent in the private equity bids compared to contemporaneous bids. Table 1 summarises the characteristics of interest and the expectations regarding frequency.

THE PROFILE OF PRIVATE EQUITY DEALS, 2005-2007

Bid samples

The takeover bids and schemes in the sample were collected over the period 1 January 2005 to 30 September 2007. The private equity sample contained 15 private equity bids where the bidder was identified as a private equity firm, or the bidding consortium involved a private equity firm. This

[46] Henry, n 40.

[47] See reg 5.1.01 and cl 8301(a)(i) of Sch 8 of the *Corporations Regulations 2001* (Cth).

[48] Eddey, n 39.

[49] Bugeja M, "Voluntary Use of Independent Valuation Advice by Target Firm Boards in Takeovers" (2007) 15 *Pacific-Basin Finance Journal* 368.

[50] See reg 5.1.01 and cl 8303 of Sch 8 of the *Corporations Regulations 2001* (Cth).

[51] See *Corporations Act 2001* (Cth), s 640.

[52] McDonald L, Moodie G, Ramsay I and Webster J, *Experts' Reports in Corporate Transactions* (Federation Press, 2003).

[53] Bugeja M, "The 'Independence' of Expert Opinions in Corporate Takeovers: Agreeing with Directors' Recommendations" (2005) 32 *Journal of Business Finance & Accounting* 1861.

[54] Bugeja M, "Independent Expert Valuations in Takeovers: Are They Biased?" (2006) 16 *Australian Accounting Review* 19.

[55] Maheswaran K and Pinder S, "Australian Evidence on the Determinants and Impact of Takeover Resistance" (2005) 45 *Accounting and Finance* 45.

period was deemed to be representative of the favourable economic environment in Australia which produced the recent increase in private equity transactions.[56] The sample consisted of bids commenced, so included bids whether successful, unsuccessful or withdrawn. It included takeover bids and merger schemes.

To compare the features and characteristics of the private equity deals, the authors created a benchmark sample of contemporaneous deals, involving other corporate bidders. These benchmark deals were selected by year and industry sector (two-digit GICS code). They totalled 65 deals. That is, the authors did not simply match deal for deal. They examined the deal year and industry sector and selected the benchmark sample by pooling all eligible matches. Table 2 shows the sample frequency by industry.

Bid data and financial data for the private equity sample were sourced from the Connect 4 "Takeovers" database and the AspectHuntley DatAnalysis database. Qualitative judgments about the type of experts' report and the type of statement about management retention were sourced by reading the bid documents and were coded by the researchers. Brand status was sourced from Interbrand, a global branding consultancy. It releases the results of survey reports on the top global brands.[57]

Industry composition

Private equity takeover bids range almost across the GICS sectors (Global Industry Classification Standard), with the exception of the energy, consumer staples and telecommunications services sectors: see Figure 1 and Table 2. However, the consumer discretionary sector is the most frequently targeted sector in both samples.

TABLE 2 Bid activity by industry

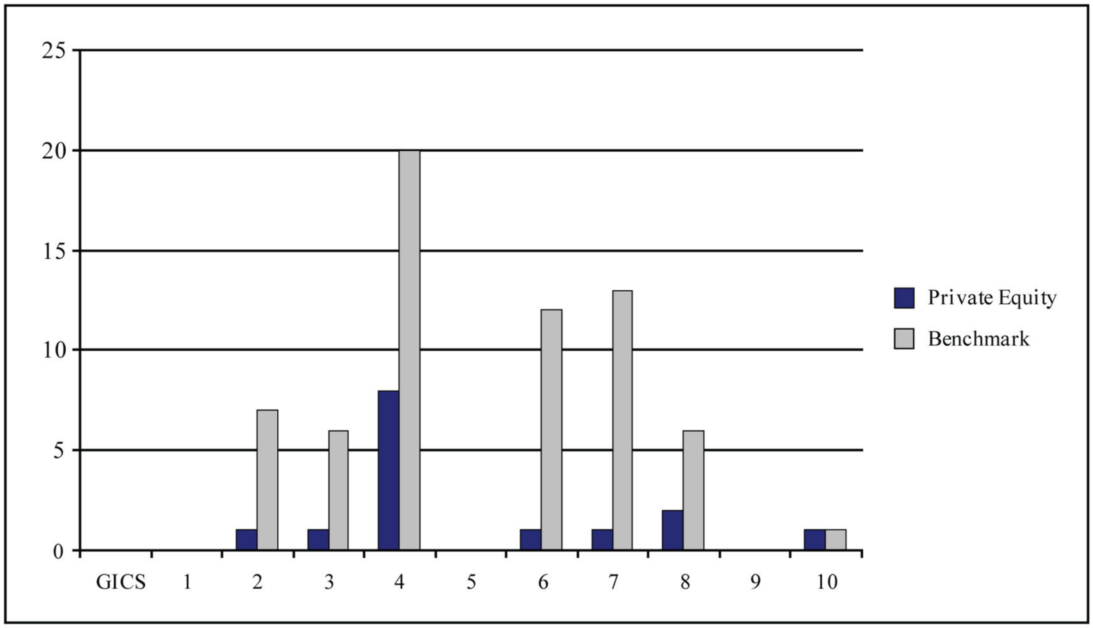
GICS sector industry group	GICS industry code	Number of transactions			
		Private equity sample		Benchmark sample	
Energy	10	–		–	
Materials	15	1	7%	7	11%
Industrials	20	1	7%	6	9%
Consumer discretionary	25	8	53%	20	31%
Consumer staples	30	–		–	
Health care	35	1	7%	12	18%
Financials	40	1	7%	13	20%
Information technology	45	2	13%	6	9%
Telecommunication services	50	–		–	
Utilities	55	1	7%	1	2%
Total		15		65	

[56] Reserve Bank of Australia, n 1; Freed and Thompson, n 9.

[57] See http://www.interbrand.com/studies_list.aspx?langid=1000 viewed 25 November 2010.

Figure 1 lists takeover activity in the private equity sample by the target company's GICS sector.

FIGURE 1 Bid frequency by industry



1: Energy, 2: Materials, 3: Industrials, 4: Consumer Discretionary, 5: Consumer Staples, 6: Health Care, 7: Financials, 8: Information Technology, 9: Telecommunications Services, 10: Utilities.

Bid characteristics

As outlined in Table 1, there are several bid characteristics identified that aggregate to form an overall characteristic of deal "friendliness". These were loosely distinguished by those characteristics controlled by the bidder, and those characteristics that were in response to the bid, usually, but not always, controlled by the target.[58] The measures and results of these analyses are shown in Table 3. In particular, Panel A shows the friendliness indicia controlled by the bidder, such as bid premium, and Panel B shows the bid response characteristics, such as target board recommendation. To further highlight the preferences of private equity bidders, Panel C and Panel D illustrate some additional deal values and target characteristics; these are not necessarily "friendliness" characteristics of the first order.

Panel C of Table 3 shows other characteristics that relate to the bid, such as offer type, bid success and deal market value, for which the authors had no particular priors on their contribution to friendliness. Typically one would expect private equity bids to be funded by cash, and Panel C shows that all private equity bids were cash. Corporate bidders in the benchmark sample also would have the opportunity to fund the bid by scrip, and the data show this. Private equity bids are significantly more successful ($p=0.030$), but generally success rates in Australian bids this decade are high (around 60-70%). This was not a study on the predictors or determinants of success of the bid. It is known that private equity bidders select large, stable targets[59] so the average deal size is significantly larger than the corporate bids ($p=0.012$).

In Panel D of Table 3, the authors speculate on other preferences that private equity firms may have in choice of target, suggesting these as second-order friendliness characteristics. The *iconic brand status* of the private equity targets is perhaps obvious from casual scrutiny and is a significant

[58] For example, a bid revision is initiated by the bidder is response to the bid take up.

[59] Chapple, Clarkson and King, n 29.

difference to non-branded corporate targets (*p =< 0.001*). The iconic, or at least well-established, status of the private equity target would lead the bidder to expect media scrutiny and general interest in the bid. If the industry wants to avoid the perception of hostility, then this may influence the structure and conduct of the bid. It is known that the private equity targets would be generally larger firms.[60] The median deal size, $564,856, was significantly larger than the usual corporate deal, median $88,657 (*p=0.002*).

Still on Panel D of Table 3, it presents three measures relating to *ownership of the target* firm. One might extend the friendliness conjecture by examining the differences between the ownership concentration and the number of blockholders for the firms subject to private equity bids and the firms subject to bids by corporate bidders. If private equity bidders want to preserve an element of friendliness to the deal, it is suggested that they will seek firms with concentrated ownership and a number of blockholders relative to other bidders, so as to be in the position to "negotiate terms" of the bid with significant shareholders prior to formally making the bid. Eddey and Casey[61] argued that a bidder seeking to gain control of a target that has substantial shareholders typically has to negotiate a bid price with the major shareholders. Moreover, Demsetz and Lehn[62] and Shleifer and Vishny[63] argued that blockholders are in a favourable position to consult directly with the bidding firm due to their significant ownership in the target firm. A blockholder is defined as a shareholder holding 5% or above of the company's shares. This definition is commonly used in Australia, given a substantial holding is defined as 5% or more of the total number of votes attached to voting shares in the body, and under s 671B of the *Corporations Act* a person with a substantial holding must disclose the information to the company.

As many of the private equity deals are mergers by way of scheme, a scheme can only take place with majority shareholder consent. Bear in mind that this is a suggestion at an informal level. In Australia, bidders are prohibited from offering any "collateral" benefits or deal inducements to some shareholders only (s 623 of the *Corporations Act*). The equal opportunity principle (s 620 of the *Corporations Act*), from the so-called Eggleston principles (s 602 of the *Corporations Act*), is well entrenched: see Calleja,[64] Ding[65] and Sheehy.[66]

The data for the number of blockholders and ownership concentration are significant at a minimum 10% level. For example, the mean (median) number of blockholders for the private equity sample is 3.80 (3.00) compared to 2.96 (3.00) for the benchmark sample, and the median is highly significant at 5% (*p=0.002*). The mean (median) ownership concentration, measured by the percentage of total equity owned by the top 20 shareholders of the firm, is 66.4% (72.9%) for the private equity sample as opposed to 67.5% (67.9%) for the benchmark sample (*p=0.085, p=0.090* mean/median respectively). Therefore, the results concerning ownership concentration and the number of blockholders are a significant point of contrast for private equity targets.

[60] Chapple, Clarkson and King, n 29.

[61] Eddey P and Casey R, "Directors' Recommendations in Response to Takeover Bids: Do They Act in Their Own Interests?" (1989) 14 *Australian Journal of Management* 1.

[62] Demsetz H and Lehn K, "The Structure of Corporate Ownership: Causes and Consequences" (1985) 93 *Journal of Political Economy* 1155.

[63] Shleifer A and Vishny R, "Large Shareholders and Corporate Control" (1986) 94 *Journal of Political Economy* 46.

[64] Calleja N, "The Equality Principle and Prohibited Benefits in Takeovers" (1999) 27 ABLR 342.

[65] Ding A, "An Interpretation of the Equality of Opportunity Principle in the Context of Benefits Prohibited under the Corporations Law" (2000) 18 C&SLJ 6.

[66] Sheehy B, "Australia's Eggleston Principles in Takeover Law: Social and Economic Sense?" (2004) 17 AJCL 218.

TABLE 3 Bid characteristics

Bid descriptive statistics	Private equity sample (n=15)	Benchmark sample (n=65)	*P-value (one-tailed)*
Panel A – Indicia of bid friendliness: the bidder			
Bid premium 5 days prior to bid			
Mean	0.121	0.248	***0.026****
Median	0.098	0.171	0.109
Bid premium 20 days prior to bid			
Mean	0.161	0.274	***0.041****
Median	0.170	0.248	0.104
Break fee			
Frequency of break fee	9	14	***0.003****
Mean % of deal	0.012	0.011	0.729
Median % of deal	0.011	0.010	0.836
Pre-bid stake			
Frequency	5	33	0.223
Mean	0.217	0.240	0.812
Median	0.170	0.198	0.475
Senior management retention			
Frequency of statement of intention that senior management might or will be retained	10	16	***0.002****
Frequency of statement that senior management will be replaced	3	33	***< 0.001****
If intent to retain			
Vague statement of retention (type 1)	6	6	0.263
Statement of retention of identified individuals (type 2)	4	10	
If no intent to retain			
No statement (type 3)	2	16	0.740
Statement – replaced (type 4)	3	33	
Bid type			
Scheme	10	19	***0.007***
Takeover	5	46	
Panel B – Indicia of bid friendliness: the bid response			
Target board recommendation			
Accept recommendation	10	44	0.406
Reject recommendation	3	6	
No recommendation	2	15	
Bid revision			
Frequency of revision	5	11	0.152
Frequency of no revision	10	54	
Independent expert reports			
Frequency of no report	0	33	***>.001****
Frequency of report	15	32	
Frequency of "best interests"	10	13	0.110
Frequency of "fair and reasonable"	2	14	
Frequency of "not fair but reasonable"	–	2	
Frequency of "neither fair nor reasonable"	3	3	
Frequency of other	–	–	

TABLE 3 *continued*

Bid descriptive statistics	**Private equity sample (n=15)**	**Benchmark sample (n=65)**	***P-value (one-tailed)***
Panel C – Other deal characteristics			
Offer type			
Frequency of cash	15	45	***0.046****
Frequency of scrip	–	11	
Frequency of both	–	9	
Bid success			
Frequency of successful	8	54	***0.030****
Frequency of unsuccessful	5	6	
Frequency of withdrawn	2	5	
Deal market value ($)			
Mean	1,834,490	535,568	***0.012****
Median	642,000	90,012	***0.001****
Panel D – Other target characteristics			
"Icon target"			
Frequency of "interbrand"	3	0	***<0.001****
Total assets – target ($)			
Mean	3,007,200	1,127,970	0.145
Median	564,856	88,657	***0.002****
Number of blockholders			
Mean	3.80	2.95	***0.045****
Median	3.00	3.00	0.187
Size of blockholding			
Mean	0.112	098	*0.087***
Median	0.096	0.082	*0.081***
Ownership concentration			
Mean	0.664	0.675	*0.085***
Median	0.729	0.679	*0.090***

[*] Significant to 5%.

[**] Significant to 10%.

For the categorical variables, the *p-* values are for the Chi-square test of independence.

DEAL FRIENDLINESS: RESULTS

Bid premium results

The bid premium results of the private equity sample and the control sample are presented in Panel A of Table 3. As predicted, the bid premium offered by private equity bidders is significantly lower than that offered by the other bidders. For example, 20 days prior to the bid, the mean (median) bid premium for the private equity sample is 16.1% (17.0%), as opposed to 27.4% (24.8%) for the benchmark sample. This difference looks descriptively different and is statistically different for the mean at the 5% level (*p=0.041*). Moreover, five days prior to the bid, the mean (median) bid premium for the private equity sample decreases to 12.1% (9.8%), compared to 24.8% (17.1%) for the control sample, and the mean is significantly different (*p=0.026*). These results suggest that private equity bidders either do not find it necessary to offer as higher premiums as existing corporate groups, or are not willing to offer such high premiums. As a lower bid premium is suggestive of a "less aggressive" deal stance, the findings provide support for the friendliness of private equity bids.

Break fee results

It is generally expected that a bidder is in a strong ex ante position vis-à-vis the target if the target board agrees to a deal protection device. The most visible deal protection device is the break fee, as shown in Panel A of Table 3. The greater existence (60% of private equity sample versus 21.5% for the benchmark sample) of break fees for the private equity sample lends support for the friendliness of private equity bids. This difference is significant (*p=0.003*). There is not a lot of interest in the break fee size – the Takeovers Panel restricts the fee to 1% of deal value (this is a guideline, not law)[67] but it shows that the market participants are highly compliant.

Pre-bid stake results

The pre-bid stake (referred to in the literature as toehold) relation across the samples is insignificant (as shown in Panel A of Table 3), and so is not informative. That there are five private equity bids (one-third) that disclose a toehold is a surprise. However, the disclosure requirement in Australia related not just to an ownership stake but to any "relevant interest" in the target shares. A "relevant interest" is a broader concept than outright ownership – it refers to any power a person (the bidder) may have in relation to exercising ownership, voting or disposal rights attached to a share (s 608(1) of the *Corporations Act*). Accordingly, the bidder can have a relevant interest in a share, and must disclose that interest as part of the bid process, even if they do not own it outright. This is consistent with the potential inside nature of private equity deals and regulatory concern over conflicts of interest.[68] For example, the bid for Flight Centre involved a consortium of bidders including private equity firm Pacific Equities and a substantial shareholder of the target, Flight Centre Founders.

Managerial retention results

Consistent with the "insider" focus of private equity deals, the authors expected the private equity bidders to be more explicit and, indeed, more favourable toward retaining the existing target board and/or senior management. In the disciplinary hypothesis, boards would expect to be replaced following a takeover or merger.[69] Accordingly, the authors investigated all the deals to measure the frequency with which target management retention is discussed and show this in Panel A of Table 3. At the first level, they coded a value of "1" for every firm that mentioned any positive statement of intention by the bidder that existing management will or might be retained. A total of 10 such disclosures were counted in the private equity sample (66%) and 16 such disclosures for the benchmark sample (24%). This difference is significant (*p=0.002*). The authors then, on the converse, coded a value of "1" for every firm that explicitly disclosed their intention to replace management. Here they counted three such disclosures for the private equity sample (20%) and 33 such disclosures for the benchmark sample (51%). This difference is also significant ($p < 0.001$). Thus, consistent with expectations, they found the private equity bidders to be more favourable toward retaining the existing board and/or senior management, while the benchmark bidders were more likely to explicitly indicate their intention to replace the board and/or senior management.

Finally, to gain further insight into the types of retention statements being made, the authors partitioned the sample based on whether the firm made a positive statement of intention to retain (26 firms), or failed to make such a statement (54 firms). The disclosures made by the private equity bidders (benchmark bidders) were then coded according to the quality of the retention statement, discriminating between four different types of disclosure:

1. a positive, albeit vague, statement of intention to retain current management: 6 (6);
2. a positive statement identifying named individuals, or their positions, as would be retained: 4 (10);
3. no disclosure about retention of current management: 2 (16); and

[67] See Takeovers Panel, n 33 at [7.15].

[68] Reserve Bank of Australia, n 1.

[69] Harford J, "Takeover Bids and Target Directors' Incentives: Retention, Experience and Settling-up" (2003) 69 *Journal of Financial Economics* 51; Bugeja M, da Silva Rosa R and Lee A, "The Impact of Director Reputation and Performance on the Turnover and Board Seats of Target Firm Directors" (2009) 36 *Journal of Business, Finance and Accounting* 185.

4. an explicit statement disclosing the intention to replace current management: 3 (33).

Here, the first two types encapsulate the forms of disclosure that a firm making a positive statement of intent to retain could utilise whereas the last two types encapsulate the forms of disclosure a firm which fails to make a positive statement could utilise. According to this scale of quality of retention statement, one would expect type 2 and type 4 to be the most informative about the bidders' intentions and attitude to the current management of the target; type 1 to be somewhat informative; and type 3, as there is an absence of disclosure, to be uninformative as to the bidders' intention regarding current management retention. However, notwithstanding this expectation, as shown in Panel A of Table 3, the form of disclosure adopted within each partition was independent of whether the bidder was from the private equity or the benchmark sample. For the 26 firms making a positive statement, the test comparing the use of a vague (type 1) versus an identified (type 2) disclosure was insignificant at conventional levels ($p = 0.263$). Similarly, for the 54 firms which failed to make a positive statement, the test comparing the use of an explicit replace statement (type 4) versus making no statement (type 3) was also insignificant at conventional levels ($p = 0.740$).

Thus, overall the results relating to the issue of managerial intention indicate that private equity bidders are more likely to explicitly state their intentions to retain the incumbent board while the benchmark bidders are more likely to explicitly state their intentions to replace the board. However, there appears to be no difference between private equity and benchmark bidders in the form of disclosure they utilise to communicate their positive intent to retain, or alternatively in the form of their communication if they choose not to make a positive statement.

Type of bid results

The frequency count shows that private equity bids prefer to structure the deal as a scheme as opposed to a contested bid: 66% of private equity deals are schemes, whereas 30% of the benchmark bids are schemes. The difference is significant ($p=0.007$). Jolley[70] provided evidence that private equity always prefers a scheme because they are easier and the win or lose outcome is more certain. The reason is that target boards in Australia have been very accommodating of the private equity bidder's desire to merge by scheme – hence this is a good signal of management cooperation and "friendliness".

Bid revision results

In the private equity sample, five deals contained a bid revision, compared to 11 of the benchmark sample. Given that bid revision incidence is low generally in Australia, the result that five private equity bids revised the terms of the bid is a surprise. There was no significant result drawn from these observations. McDougall[71] and Henry[72] suggested that bid revisions influence success, but the current authors examined all relevant deals, not dependent on outcome.

Expert report results

Once a bid has been made, the target board has the opportunity to commission an independent expert report. Bidders who already have a pre-bid stake of 30% will trigger the mandatory expert's report requirement. Section 640 of the *Corporations Act* requires the target to commission an independent valuation report on whether the bid is fair and reasonable; a similar mandate exists for schemes ("best interests"). All of the private equity bids have expert reports, compared to 50% of the benchmark sample, and this is a significant difference ($p=<.001$) between the samples. Nonetheless, the market's perception of expert reports is that they are conflicted, compromised and inaccurate. The authors further categorised the reports' outcomes into four categories for private equity bidders (benchmark bidders), discriminating between:

1. favourable – best interests: 10 (13);
2. favourable – fair and reasonable: 2 (14);

[70] Jolley B, "Moving to 100% Ownership After a Private Bid" in Austin and Tuch, n 4.

[71] McDougall F, "Factors Influencing the Outcome of Takeover Offers" (1974) 10 *Abacus* 111.

[72] Henry, n 40.

3. unfavourable – not fair but reasonable: 0 (2); and
4. unfavourable – not fair not reasonable: 3 (3).

Although there were three unfavourable reports for private equity bids (25%) and five unfavourable reports in the benchmark sample (7.5%), there is no statistical significance to be attributed to these results. The tactic of resorting to an expert's report may traditionally be seen as resistance (hostility) on the part of the target board. But the reality here is that many boards may not have a choice, given the disclosure mandates.

Profile of a private equity bid

Table 1 above summarised the characteristics of interest and the expectations regarding frequency of these characteristics by comparing private equity bids with other contemporaneous bids. The univariate results of this comparison show that private equity bidders typically offer less for the target, are in a position to utilise a deal protection device such as a break fee and offer incumbent management a continuing role in the business. Private equity also prefers to structure a deal as a Ch 5 merger/scheme than as a bid. The authors present these as characteristics of friendliness of the first order. There were other characteristics that were posited as being relevant, but for which the current study did not provide evidence of any difference between the samples: pre-bid stake, target board recommendation, bid revision, and quality of an independent expert's valuation report. In a more speculative set of characteristics, presented as characteristics of friendliness of the second order, the authors show that the "iconic" brand of the private equity target and ownership concentration are also important features.

Profile of a successful private equity bid: Case study example

To further illustrate the "typical" bid arrangements of a successful private equity bid, the takeover of DCA Group Ltd (DVC) is profiled.[73] The company DVC was in the health care industry, and the takeover of DVC by the bidder CAID Pty Ltd (CVC) received considerable media attention. This bid was characterised as a private equity bid in the sample because the bidder was a company ultimately owned by the global private equity firm CVC Asia Pacific Ltd and CVC Capital Partners.

CVC made a takeover offer for DVC by way of a *scheme of arrangement* on 25 September 2006. The bidder offered $A3.50 in cash for each DCA share, less any dividend paid prior to the implementation of the scheme.[74] Twenty days prior to the bid, the share price was $2.59, so the bid premium was valued at this point at 33.59%. The non-executive directors of DVC announced that they intended to vote in favour of acceptance of the offer. The directors' recommendation was supplemented by an independent expert's report from Grant Samuel (costing $400,000) that considered the offer to be in the *best interests of the shareholders*. There is no evidence that this report was mandatory – it appears to have been commissioned by target directors *voluntarily*.

The offer price of $3.50 per share, which although at 20 days out represented a premium of 35.59%, five days prior to the bid, and two days prior to the bid, the bid premium had decreased to 9.85% and 7.12% respectively. The bid was *not revised* during the process. A *break fee* provision was included in the bid, which stipulated a payment of $17.8 million to CAID Pty Ltd by DVC in certain limited circumstances.[75] This break fee amounted to 1.09% of the deal value.

In terms of *management retention*, CVC issued a media release with a very positive statement regarding retention of existing management:

[73] There are several other case study examples in the ACSI Report, *Public Companies Being Taken Private: A Research Report into Private Equity* (2009), study commissioned by the Australian Council of Super Investors Inc and prepared by the Melbourne Centre for Financial Studies.

[74] CVC's offer of A$3.50 per share included the already announced fully franked final dividend of A$0.04 to be paid on 25 October 2006.

[75] Although the DCA Group Ltd Scheme Booklet referred to "limited circumstances", in fact the circumstances seemed to be quite standard provisions including where any director of DCA withdraws support for the CAID Proposal or gives support for a competing offer or where DCA contravenes the non-solicitation or no-talk obligations.

> Members of DCA's senior management team will remain with the Company and have agreed to invest alongside CVC, ensuring the retention of valuable experience to support the day-to-day operations of the company and consistency in the delivery of patient care.[76]

In the data when the authors coded the strength of the retention statement, as the scheme documents actually identified by name the management team, this was treated as the most positive statement of retention. Interestingly though, this endorsement caused a "backlash" in the media, as "unnamed" institutional investors were reported to be unhappy with the conflicts this generated.[77]

The profile of the successful private equity takeover of DCV largely supports the results found in investigating the characteristics of private equity bids. The *bid premium* may have seemed quite large at 20 days out, but the independent expert opined that:

> The volatility of the DCA price makes it difficult to draw reliable conclusions about the premium for control … However, on any basis the CAID Proposal represents premiums that are at the high end of premiums typically observed in takeover offers.[78]

The directors supported the deal. *The deal structure was a scheme, not a bid*. Moreover, the independent expert's recommendation was positively associated with the target board of directors' recommendation. A bid revision was not necessary in the CVC bid, further supporting the friendly negotiation of the terms of the bid. A break fee was included in the conditions of the bid, suggesting CVC was in the position to be able to negotiate a break fee into the transaction. Indeed, the company had announced earlier on 8 September 2006 that the directors had reviewed proposals received from a number of independent parties in respect of DVC's ownership – although at that stage no potential bidder was named.[79] The bidder had *no toehold* in the target, which would be expected from a private equity firm.

CONCLUSION

This study has found an array of characteristics that may lead to the characterisation of deal friendliness. The traditional M&A literature tends to characterise deals as hostile or friendly, depending on the target board's response. The target board's response, though, is an event that happens after the deal is launched. Examining private equity deals and their preference to avoid hostility shows that this "tone" is a more subtle combination of characteristics, and it can be "set" by the bidder ahead of the formal bid launch. The characteristics that relate to the bid structure that the bidder can control (first-order characteristics) relate to the bid premium, the format (scheme versus bid), the ability to negotiate a break fee and promises relating to the future role of senior management and the board after the merger. Private equity bidders are more inclined to make some positive statement about retaining the current target management, and also are more reluctant to make an outright statement regarding rejection/replacement of current management.[80] Apart from accounting measures relating to performance and cash flows – this has already been examined[81] – the authors also show second-order preferences of private equity: an appetite for iconic brand targets, which are large established firms that have higher ownership concentration.

The authors also observe that private equity bidders typically pay by cash, are more successful and transact in larger deal values but do not claim that these particular characteristics relate to an overall tone of friendliness.

[76] CVC Capital Partners, *Media Release* (8 December 2006), http://www.cvc.com/Content/En/MediaCentre/PressRelease.aspx?PRID=109 viewed 24 March 2011.

[77] See eg Ahmed N, "DCA Shareholder Calls into Question CVC Deal", *The Age* (7 October 2006) p 4.

[78] DCA Group Ltd Scheme Booklet, p 25.

[79] Colman E and Clow R, "DCA Dissects Multiple Takeover Bids in $2.5bn Private Equity Raid", *The Australian* (9 September 2006) p 31.

[80] This study is indifferent as to whether the private equity bidder ultimately acts on its promises or not. Whether the private equity bidder ultimately retains or replaces managers despite its stated intentions does not reflect on the friendly tone of the deal.

[81] Chapple, Clarkson and King, n 29.

The evidence presented further provokes challenges on several points. The authors are not able to report on the differences between the sample populations, despite prior expectations. In particular, the "hostility" characteristics of pre-bid stake and the use of independent expert reports require further investigation. The traditional expectation is that the acquisition of a pre-bid stake is an aggressive pre-bid manoeuvre – the authors are unable to show this. Similarly, the use of an expert's report is traditionally viewed as target board resistance, indicating hostility, yet the entire private equity sample featured these reports and it was shown to be a significant difference. It may be that the Australian market and regulatory imposts provide contextual differences that do not conform to traditional expectations.

Finally, there may be other characteristics of "friendliness" that have not been examined. For example, the role of the bid revision is contentious in any takeover and the sample shows this occurred in one-third of private equity bids. If this type of disruptive strategy, that the bidder controls, is important, there may be other bid-in-play strategies not examined. For example, the role of the Takeovers Panel in intervening in bids-in-play is one dimension not characterised in this study but it could have a contentious role to play in the proposed "friendly deal" matrix. Apart from examining management retention as a characteristic of friendliness, the authors have not posited that any other board or governance characteristics of the target firm are of interest to private equity bidders.