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Shareholder Returns of Hostile Takeover Targets

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This morning [October 22, 2014], Institutional Shareholder Services (ISS) issued a note to clients entitled "The IRR of 'No'." The note argues that shareholders of companies that have resisted hostile takeover bids all the way through a proxy fight at a shareholder meeting have incurred "profoundly negative" returns following those shareholder meetings, compared to alternative investments. ISS identified seven cases in the last five years where bidders have pursued a combined takeover bid and proxy fight through a target shareholder meeting, and measured the mean and median total shareholder returns from the dates of the contested shareholder meeting through October 20, 2014, compared to target shareholders having sold at the closing price the day before the contested meeting and reinvesting in the S&P 500 index or a peer group.

A close look at the ISS report shows that it has at least two critical methodological and analytical flaws that completely undermine its conclusions:

- ISS's analysis refers to Terra Industries as one of the seven cases in the last five years where a target had resisted a hostile bid through a shareholder vote on a bidder's nominees, but the analysis then excludes Terra from its data analysis, by limiting it to targets that ultimately remained standalone. Terra is one of the great success stories of companies that have staunchly resisted inadequate hostile takeover bids, even after the bidder succeeded in electing three nominees to its board, and ultimately achieved an outstanding result for shareholders. As ISS notes, if the pre-tax cash proceeds of the final cash-and-stock offer for Terra had been reinvested in shares of the bidder, Terra shareholders would have seen a total return of 271% from the date of the initial shareholder meeting through October 20, 2014, significantly beating the S&P 500 Index and the median of peers by 181 and 211 percentage points, respectively. Had ISS properly included Terra in its analysis of "The IRR of 'No'", the mean return of the seven companies would have beaten the S&P index by 18.4 percentage points (compared to a shortfall of 8.7 percentage points when Terra was excluded) and beaten the ISS peer groups by 10.0 percent (compared to a shortfall of 23.6 percentage points excluding Terra).

- Of the seven cases discussed in the analysis, one was a micro-cap company with a market cap of $250 million (Pulse Electronics) and one was a nano-cap company with a market cap of $36 million (Onvia). The other five companies, including Terra, had market caps between approximately $2 billion – $8 billion, yet ISS treats them all equally. A market-cap weighted analysis would have had dramatically different results. Excluding the micro-cap and nano-cap companies from the analysis, the mean and median returns for the five companies (including Terra) exceeded the S&P Index by 65.4 percentage points and 1.4 percentage points, respectively, and exceeded the respective peer groups by 57.6 percentage points and 20.8 percentage points, respectively.

More broadly, the real world of corporate takeover practice demonstrates that prudent use of structural protections and “defensive” strategies provides boards—and shareholders—with the benefits of substantial negotiating leverage and enhanced opportunity to demonstrate that the company’s stand-alone strategy can deliver superior value.