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COPEINCA: A HOSTILE TAKEOVER

COPEINCA: UNA TOMA DE CONTROL HOSTIL

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Abstract

This article presents the dilemma faced by real investors with the emergence of a takeover bid on an existing company. The private benefits that accrue from control mean that defence mechanisms are deployed in the event of a takeover that is considered to be hostile. The article has been written with the sole intention of providing an educational case study for the teaching of Mergers and Acquisitions and Corporate Governance. The character Ricky Spanish is fictional and does not disguise the identity of any real investor. Local press articles and official documents such as company information prospectuses were examined during the preparation of the case study. The facts presented are accurate but the article is not intended to be a work of history. Theory-based analysis permits an approach to the problem of assessed value, which is contrasted with market value. Different scenarios and alternative viewpoints are presented to allow readers to draw their own conclusions. It is observed that the founding family, board members, company executives and press all fail to understand that the company is no longer owned exclusively by its founders. There is a lack of clarity concerning appropriate ways to deal with conflicts of interest between majority and minority shareholders. In markets characterized by decidedly concentrated ownership structures, it is very unlikely that hostile takeovers will occur. The case study identifies the principal benefits and risks faced by investors in a company from a medium income country that cross lists in developed markets.

Keywords: Corporate governance, mergers, acquisitions, hostile takeovers, private benefits of control.

Resumen

Se plantea la disyuntiva de inversionistas reales ante el surgimiento de una oferta pública de adquisición en una empresa existente. Los beneficios privados originados por el control impulsan la utilización de mecanismos de defensa ante una oferta etiquetada de hostil. Este texto ha sido escrito como un caso de estudio con fines exclusivamente pedagógicos en las áreas de Fusiones y Adquisiciones y Gobierno Corporativo. El personaje de Ricky Spanish es de ficción y no enmascara a ningún inversionista de la vida real. Se revisa artículos aparecidos en la prensa local así como documentos oficiales como el prospecto informativo. Los hechos son fidedignos pero no se trata de una crónica. El análisis basado en la teoría permite armar una aproximación a la valorización que se contrasta con los valores de mercado. Se presentan diferentes escenarios y puntos de vista alternativos para que el lector saque sus propias conclusiones. Se observa como la familia fundadora, los miembros del directorio, los ejecutivos de la empresa y los medios de prensa fallan en reconocer que la empresa ya no es de propiedad exclusiva de los fundadores. Falta claridad al encontrarse situaciones de conflicto de intereses entre los accionistas mayoritarios y minoritarios. En mercados

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caracterizados por una estructura de propiedad muy concentrada es poco probable observar una toma de control hostil. El caso identifica los principales beneficios y riesgos para los inversionistas de una empresa de un país de ingresos medios, que co-lista en mercados desarrollados.

Palabras clave: gobierno corporativo, fusiones, adquisiciones, toma de control hostil, beneficios de control privado.

Introduction.

Ricky Spanish wakes up startled from a dream (or nightmare) in which he recalls a voice announcing that "**Copeinca will no longer be quoted both in Oslo and in Lima**". Groping in the dark, he reaches for the newspaper that has been slipped under his door and reads the date: "2 August 2013". He leafs through the paper anxiously in search of the headline that bothers him so much. Failing to find it, he feels relieved, but goes on to read: "**China Fishery already owns 97.72% of Copeinca. Purchase to be finalised on 23 August**". The headline surprises him. He had thought that everything had already been concluded. Why are the Chinese so determined? If the takeover is hostile, why is Copeinca unable to defend itself? What happened to the Norwegians who were going to save us? Ricky decides to make an informed decision. He will not let others decide for him. He begins to look through the pile of newspaper articles that he has been gathering in an orderly pile on top of the coffee table. He has not paid much attention to them up to now. Now he realizes his mistake. Upon reflection, he understands that he had enjoyed no other effective source of information. He had not attended the annual general meeting, despite having been notified of its date. He had no intention of traveling to Oslo, and much less to read the acquisition prospectus that had received at the time. Financial statements are not his thing. Ricky is more of an intuitive investor who thinks he is well connected, and until now, his few adventures in the stock market have been inspired by the recommendations of very good sources. Until now.

When Ricky Spanish woke up this morning he was a very minor shareholder, one of many others like him in a company that now seems to be under the control of Grand Success Investment-Singapore Private Limited, a subsidiary of China Fishery Group Limited. But when he went to bed last night he had been a shareholder of Copeinca ASA (Copeinca), a family-owned Peruvian company, or at least so he had thought. Something has happened, and he has not been told about it. How is that possible? Arranging his newspaper cuttings, Ricky reviews the sequence of events.

A fishing company in Peru.

Peru is a fishing country par excellence, with a sea rich in species. However, this natural wealth is affected from time to time by the climatic phenomenon known as El Niño ("the Boy Child" in Spanish, so-named because it occurs close to Christmas time). Since Pre-Columbian times, the inhabitants of what is now Peru have had a special relationship with the sea and its products. However, deficient transport and refrigeration infrastructure, as well as culinary traditions, have meant that the population has not in general benefited from the direct consumption of fish. Fishing activities are regulated, with the application of closed seasons for certain species and the imposition of quotas. Artisan fishermen argue that the very structure of the industry works against them, while the supervisory capacity of the state is limited because of the operational limitations of the coastguard. Fishing, and in particular the production of fishmeal for industrial use, constitute important traditional sources of foreign income, competing with mining and agriculture. Peru accounts for 30% of the global production of fishmeal and 41% of global exports (Gestión, March 12, 2013). Copeinca has been quoted on the Oslo Stock Exchange since 2007, when it issued shares worth $100 million, which was followed by a further issue of $130 million (Gestión, April 2, 2014). The company is also quoted on the Lima Stock Exchange. In 2012 it was the second largest Peruvian fishing company in terms of exports. The company has five fishmeal-processing plants and 36 vessels, with a storage capacity of 14,690 cubic meters. In 2012, it produced 232,554 metric tonnes of fish and had an income of $314.2 million (Gestión, February 27, 2013). The majority of its income (78%) comes from the sale of fishmeal, while 19% derives from the production of fish oil.

Ricky has always felt comfortable as a minority shareholder in the fishing company while it has been controlled by the founding family. In addition, his 1,030 shares had each cost him $7.23, or 41 Norwegian kroner (NOK), and that amount is all that he stands to lose. For him, shareholding has effectively been a way of saving. He has not lost any sleep over the fact that his shares

have not appreciated compared to investments of similar risk. He has been satisfied with the fact he was not actually losing money, and convinced that in the long term he could only come out on top. It appears that Copeinca's quotation on the stock market was not such a good idea. Or was it?

The takeover bid.

Everyone is taken by surprise by the China Fishery Group Limited (CFGL) bid to control Copeinca ASA and its subsidiary Pesquera Copeinca, which values its net equity at $555.80 million. It is unusual to observe this type of bid in the local market, because of the particularities of concentrated ownership structures. The takeover bid, which is regulated by the Oslo Stock Exchange and offers $9.50 (NOK53.85) per share, will run from 14 March to 12 April 2013. Compared with an average reference price of $7.23 (NOK41.00), the bid implies a premium of at least 31.3%. The offer is conditional upon the purchaser obtaining a participation of 50.01%. CFGL, which did not have any prior ownership interest in Copeinca, has previously held discussions with a group of shareholders representing up to 41.5% of net equity and is confident that their bid will be successful.

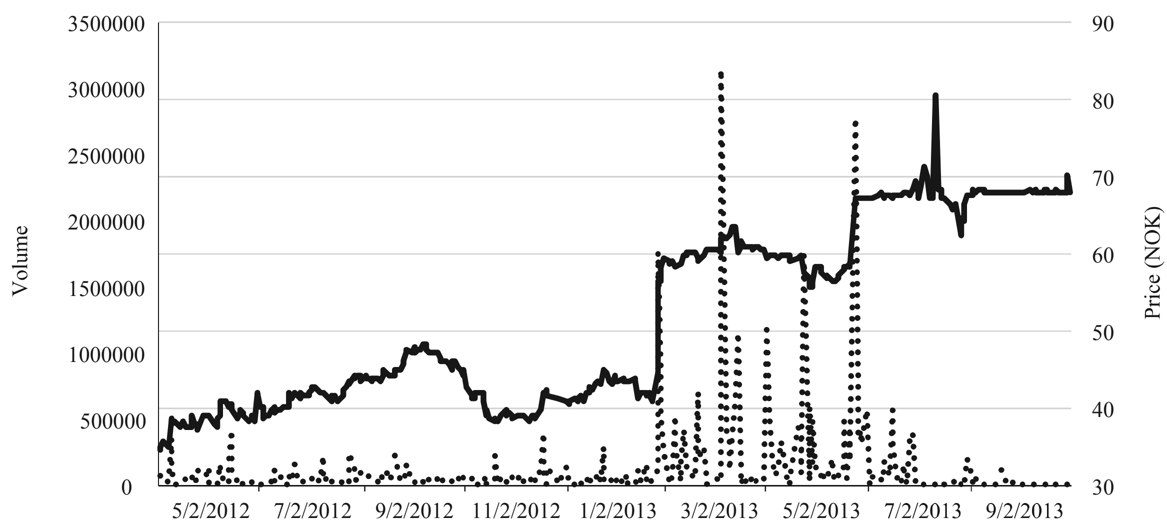
After the takeover the plan is for Copeinca's assets to be added to the 28 vessels (with an overall capacity of 9,000 metric tons) and seven processing plants (capacity 608 tons per hour) that CFGL already possesses through a subsidiary (Gestión, February 27, 2013). However, some of Copeinca's most valuable assets (such as its fishing permits) are intangible and do not appear on the balance sheet. After combining its current fishing quota with that of Copeinca, a successful bid will give CFGL control over 16.9% of the fish catch in the northern and central coastal region, and 14.7% in the southern zone (Gestión, 27 February 2013).

Takeover defences.

Copeinca's majority shareholder, who owns 32.6% of the shares and controls the board of directors with the support of Weilheim Investment, another shareholder who itself holds 6% of the company's shares, tries to convince all the other shareholders to reject the bid. Copeinca's board of directors implements strategies to frustrate the offer, initially (Gestión, 4 March 2013) labelling the bid, which offers a control premium of 31.3% over the reference price (Figure 1) as hostile. The board then officially declares itself against the offer and recommends other shareholders not to accept it, on the grounds that it is against the best interest of the shareholders. It is important to highlight the distancing of Ivan Orlic (Ocean Harvest SL) from the Copeinca board, on the grounds that his support for the CFGL bid creates a conflict of interest (Gestión, March 13, 2013). The firm's executives (the

Figure 1. Share price of Copeinca.

Daily stock price and volume



The following figure shows the variation in the closing share price (solid line) and the traded volume (dotted line) thereof on the Oslo Stock Exchange during the period between June 21st, 2012 and June 21st, 2013, without reflecting adjustments for dividend payments or changes in capital.

Source: Bloomberg L.P.

CEO and CFO) join the campaign against the offer, highlighting Copeinca's profitability and announcing investment, diversification and expansion plans, which have guaranteed future financing but that have not previously been made public (Gestión, March 12, 2013). However, the investors are not swayed by these arguments, but only by the cold numbers. With a return on equity (ROE) of 12%, the market price does not seem to reflect the supposedly superior efficiency of current management arrangements (Table 1).

Table 1. Selected financial information of Copeinca.

Balance sheet	(Unaudited)	(Audited)	(Audited)	(Audited)
	$ x 1 000	$ x 1 000	$ x 1 000	$ x 1 000
	2012	2011	2010	2009
Non-current assets	666 530	627 077	592 230	584 898
Current assets	87 660	166 437	77 289	94 384
Total assets	754 190	793 514	669 519	679 282
Total current liabilities	49 224	98 056	40 386	84 523
Total non-current liabilities	294 846	306 815	297 396	216 343
Total liabilities	344 070	404 871	337 782	300 866
Total net equity	410 120	388 643	331 737	378 416
Total liabilities and net equity	754 190	793 514	669 519	679 282
Income statement				
Sales	314 219	254 478	233 042	203 161
Cost of sales	196 862	143 085	151 037	144 615
Gross profit	117 357	111 393	82 005	58 546
Gross margin	37.3%	43.8%	35.2%	28.8%
Ebitda	103 807	106 466	75 704	59 003
Ebitda margin	33%	41.8%	32.5%	29%
Profit before taxes	71 355	64 235	-(17 125)	3 315
Profit attributable to capital	49 597	47 769	-(6 493)	255
Profit per share (basic) (USD)	0.8602	0.8187	-(0.111)	0.0044
Profit per share (diluted) (USD)	0.8602	0.8097	-(0.111)	0.0043

Source: SMV (2013).

The board of directors deploys another defensive tactic, seeking to identify a third party willing to make a competitive offer before the original term expires, and seeking to extend the time available (Gestión, March 25, 2013). For the bid to fail, the current majority shareholder only requires a loyal party to buy 11.41% of the outstanding shares, take a seat on the board and maintain the status quo. This White Squire would need to invest about $63 million. Note that the term White Squire is drawn from the colourful language of fairy-tale and that such figures do not exist in the business world. But, who might wish to become a minority shareholder, when other minority shareholders, such as Ocean Harvest SL which -with its 13.9%, assured control of the board by the majority shareholder- are queuing up to jump ship (Gestión, March 4, 2013).

Valuation.

Besides the discounted cash flow method, other mechanisms may be used to value a company, such as the analysis of comparable companies and comparable transactions. A commonly-used multiple is the EV/Ebitda ratio, where EV (Enterprise Value) is the sum of net equity value (in this case, $555.8 million) and net debt ($344.0 million – Table 1). Ebitda (earnings before interest, taxes, depreciation and amortization) is compared to Enterprise Value rather than to net equity, because Ebitda indicates cash flow before remunerating debt and equity. Ebitda measures managerial capacity to generate economic cash flows (without debt) by using the assets assigned to it. The original offer values assets at 8,668 times Ebitda. This ratio should be compared to other firms that have been involved in similar recent transactions. In addition, specific methods may be used to measure value in a given industry, for example, price per room or average occupancy in the hospitality sector. In the fishing industry, previous similar transactions can be analysed to establish an average value of the fishing quota. The transactions announced on the Peruvian market in 2011 by Negocios Rafmar, Pesquera Dafeli, Pesquera Kairo y Kim, and Velebit and, in 2010, by Pesquera Alejandría suggest an average price for 1% of the fishing quota of $97.38 million (Table 2). This figure, when multiplied by Copeinca's 10.7% market participation in the northern and central coast and 3% in the southern region (assuming equivalent value) results in a total value of $1,334.10 million for the firm's assets. This valuation assumes that all other firm assets are irrelevant or that their value is included in the value of the fishing quota. No amount is added for the value of other assets, unless they could be liquidated without affecting the fish catch and the processing and commercialization of fishmeal and of fish oil and its by-products. The asset value is reduced by the value of debt ($344 million) to arrive at approximately $990 million of net equity value. Using this valuation method the offer amounts to a 33% discount for the assets of Copeinca when compared to similar transactions, and a discount of 44% for net equity. The majority shareholder uses a similar calculation to refuse CFGL's offer (Gestión, March 12, 2013). But the offer is in fact 31.3% higher than the reference market price. It is believed that Ocean Harvest SL, one of the minority shareholders, has accepted a value of $54.80 million for 9.9% of the outstanding shares, effectively recognizing a net equity value of $553.5 million, which is close to the offer made (Gestión, March 13, 2013).

The board of directors announces a capital increase amounting to 17.88% of final equity, making the takeover bid more expensive and reducing the chances of a

successful bid (El Comercio, April 6, 2013). The capital increase means that the company issues new shares, making it possible for the Norwegian company Cermaq alone to purchase 17.88% of the new total for $120 million. Using the rule of three, the total value of Corpeinca's net equity reaches $671.1 million. Any shareholder should be able to understand that the new reference level is therefore $11.47 (NOK65.02) per share. This value is 20.7% higher than CFGL's offer of $9.50 (NOK53.85) per share and higher than the price reportedly received by Ocean Harvest SL.

Table 2. Valuation of Copeinca.

Implicit price of 1% of the fishing quota			% of the quota	13.7
	$ million	Year	North and Central	10.7
Negocios Rafmar	88.8	2011	South	3.0
Pesquera Dafeli	101.0	2011		
Pesquera Kairo y Kimi	93.3	2011	Company value	1 334.11
Velebit	105.4	2011	Liabilities	344.07
Pesquera Alejandria	98.4	2010	Equity value	990.04
Average	97.38			

Comparable transactions method of valuation

Source: Gestión, March 12, 2013.

The competitive offer.

Simultaneously with the capital increase, and as a result of having obtained 17.88% of the company´s shares, Cermaq offers to buy all of Copeinca's remaining shares, including those of the majority shareholder, at $10.53 (NOK59.7) each. Cermaq's offer is approximately 11% higher than the $9.50 (NOK53.85) per share offered by CFGL. The competing offer represents a quantitative but also a qualitative difference. Cermaq plays the role of the White Knight, improving the offer and promising to maintain part of the existing board. It is potentially dangerous for investors to trust in the role that might be played by a fictional character in their value equations. It is surprising that Copeinca's majority shareholder expects to receive shares of Cermaq (8% of the total) and to become as a result the second largest shareholder in the company after the Norwegian government (El Comercio, April 6, 2013).

Copeinca's Annual General Meeting

Copeinca's Annual General Meeting is held in Oslo on 12 April, with the attendance of shareholders who together own 74.16% of the company. It is noteworthy that both Cermaq and Grand Success Investment attend the Annual General Meeting. Both have allegedly acquired shares from Copeinca in an irregular manner during the takeover process, but nevertheless they are allowed to participate in the meeting. The former benefited exclusively from a capital increase while the latter is attending because of shares purchased from Ocean Harvest SL even though the takeover has not concluded. As will be seen, in the end the takeover bid failed. All of the shares were returned and were not paid for. The agenda, the date and place of the meeting are determined by the board. Some members of the board are re-elected, new people are appointed and their levels of compensation agreed. Gestión (April 15th, 2013) reports that in total, eight directors -Samuel Dyer Coriat, Kristjan Th. Davidsson, Samuel Dyer Ampudia, Mimi K. Berdal, Marianne Johnsen, Sheyla Dyer Coriat, Jon Hindar-CEO (of Cermaq) and William Dyer Osorio- will share $553,791.

The improved offer.

CFGL reacts, improving its offer to match Cermaq's $10.53 (NOK59.7) per share (Gestión, April 11, 2013). Furthermore, it also now seeks 100% of the shares, including those of the majority shareholder and the others acquired by Cermaq following the capital increase. By matching the quantitative terms, the difference between both competitive offers becomes entirely qualitative. Both competitive offers coexist and expire at the same time. Both are for the same price and for up to 100% of the shares, but they are conditioned upon obtaining control. Only one of the bidders can obtain control, but it is possible that neither will do so. Once control is achieved, the buyer must accept all the shares offered it, but not necessarily those that were offered to the other bidder. Shareholders can only accept one offer. If one buyer does not achieve control, it can withdraw or still accept any shares tendered to it. Clearly, minority shareholder are more likely to be able to ensure their investments are profitable during the lifetime of the offer than afterwards.

The White Knight stumbles.

It was bound to happen: a third party enters the dispute uninvited. Marine Harvest, a Cermaq shareholder, opposes the purchase of Copeinca and offers to buy all Cermaq shares that are not in the possession of the Norwegian government if Cermaq withdraws its bid for Copeinca. Once again, the offer is labelled as hostile. In this case the bid is made up of 50% cash and 50% in shares, implying a premium of 22%, and worth $1,690 million (Gestión, May 2, 2013). The Cermaq shareholders must decide whether to vote to buy Copeinca, indebting the company, consuming its cash and admitting the dilution that issuing shares implies. They presum-

ably expect there to be synergies between Cermaq and Copeinca (salmon/fishmeal and fish oil risk). The alternative is to take the cash that is being offered and to accept the risk implied by the combined Marine Harvest-Cermaq offer.

The offers expire without success.

A minority of Cermaq shareholders (37.52%) voted against the company's own offer for Copeinca at its Annual General Meeting (Gestión, May 22, 2013). It proved impossible to ensure the financing because the capital increase was not approved. The company bylaws indicate that votes of this kind require a qualified majority (66% of voters). Cermaq's share price rises to a level above the valuation of Marine Harvest's offer. As well as considering the offer of Marine Harvest, Cermaq must also decide whether now to accept CFGL's offer for the Copeinca shares, whether to withdraw its own offer, or whether to seek alternative sources of financing in order to continue with its offer. The signals are mixed: the financing is not approved, but Copeinca's majority shareholder who will only receive shares from Cermaq (8%) if the transaction is completed, is elected to Cermaq's board. CFGL's offer is not successful either. Only 36% of the shares are tendered (Gestión, May 27, 2013). None of the shares in the offer are purchased. The defensive tactics of the controlling shareholder are successful, but they destroy value for shareholders. Cermaq helps to block the offer. The shareholders lose the possibility of receiving the control premium and remain subject to the decisions of existing management. The majority shareholder of Copeinca lands a seat on the board of Cermaq and Cermaq is present on the board of Copeinca. The minority shareholders of Copeinca have nothing to celebrate. At the request of some investors the Oslo Stock Exchange initiates an investigation into the transactions of Cermaq and Copeinca during the period of the takeover bid of CFGL and of Cermaq's competitive offer (Gestión, June 20, 2013). These transactions included an increase in Copeinca's capital, which was exclusively directed at Cermaq.

A new hope.

CFGL goes back on the offensive. The original offer of $9.50 (NOK53.85) per Copeinca share, valued its equity at around $555.8 million, while the new one, at $10.53 (NOK59.70) per share, constitutes a valuation of $616.2 million. The second offer is unsuccessful because it fails to meet the condition of obtaining control of 50.01% of the shares. It also differs from the first in that it is for the purchase of up to 100% of the shares. After the failure of the second offer, the third, of $11.24 (NOK68.17) payable in cash, values the equity of Copeinca at approximately $790 million, or NOK4.8 billion (Gestión, June 25, 2013). The offer continues to be labelled as hostile, although the premium is greater than in the Cermaq's offer, equally ill-fated. The new control premium is 66.2% above Copeinca's reference market price prior to the first offer. This time, Copeinca's the controlling group accepts the offer, and this precedent is followed by the executive group. The market price immediately moves towards the offer price. The offer is valid for 20 business days. Now, the board of directors is claimed as the new hero of the minority shareholders since they have managed to maximize value. The third takeover bid for Copeinca (just as hostile as the previous ones) concludes successfully with the acceptance of 97.72% of the shares (Gestión, August 2, 2013). The conditions for the successful conclusion of the new offer are satisfactorily met. The whereabouts of the Copeinca shareholders who are yet to accept the offer appears to be unknown. It would not appear prudent for any minority shareholder to maintain their holding voluntarily given such a dominant new controlling interest. Not accepting the offer also means missing out on the premium of 66.2%.

Explore the options available to Ricky Spanish. Time is a constraint. He must act quickly.

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