PRUDENTIAL **INSIGHTS**

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JULY 2018

Can shareholder activism really add value?

In the face of Steinhoff and other cases of shareholder value destruction in the past year, we've heard much discussion around the effectiveness of shareholder activism. Prudential strongly believes in being an active and engaged shareholder to both protect and unlock value in our clients' investments. An excellent example of this is the hostile takeover attempt of poultry producer Sovereign Foods by Country Bird Holdings (CBH), a local rival, which we opposed.

Sovereign's journey is illustrated in the accompanying graph. Prudential first bought a small stake in Sovereign in 2005, but when the takeover battle began we were the company's largest shareholder with a 23% stake. At the time of CBH's opportunistic offer in 2016, the (very cyclical) poultry industry had been suffering from oversupply, overcapacity and falling product prices. Some companies, including Sovereign, had high debt levels, and Sovereign had been forced to undertake two rights issues at a discounted price to raise capital. Compounding this, the market was hit by an influx of cheap chicken imports and rising feed costs during the country-wide drought.

Sovereign Foods: Fending off a hostile takeover bid

Source: Bloomberg

It was at this point of maximum industry-wide pain that CBH launched its takeover bid at R9 per share. For some shareholders this offered an attractive exit strategy, but we felt that it was the wrong point in the industry cycle to sell, and that the bid materially undervalued the company, especially given the improving industry outlook: profits were forecast to rise on the back of a projected record harvest and falling feed prices.

As such, we backed Sovereign's management in their attempts to remain independent. We were vocal in the media about our view, engaged with other stakeholders and made a submission to the Takeover Regulation Panel in support of management, which successfully opposed CBH's unlawful attempt to amend the terms of its offer after it failed to receive the required shareholder approval. The defeat gave Sovereign a 12-month reprieve during which CBH was not allowed make another offer for the group. It was during this period that private equity company Capitalworks led a R12 per share bid for Sovereign in August 2017. Although we believed this higher offer still undervalued the Sovereign business, we reluctantly accepted it. This was because CBH's stake in Sovereign had crept up to 34%, and we were concerned that CBH would be able to trigger an offer to minority shareholders and gain control by buying shares in the market at less than R12. The Capitalworks offer was supported by Sovereign's board and management, and approved by shareholders in October 2017.

Although Sovereign was de-listed from the JSE following its buyout (so its recent financial performance has not been disclosed), the poultry industry subsequently experienced a significant turnaround. Chicken feed costs fell substantially, while selling prices rose as some producers cut back their supply, impacting positively on producer margins. This is evidenced by the larger listed Astral Foods, which saw its profit margin rise from 12.5% to nearly 17.5% in the six months to 31 March 2018. This recovery shows that we were correct in holding out for a 33% better – albeit not ideal – price for our investors. When voting on corporate actions, we always aim to protect the long-term value of companies in which we hold shares, to uphold our clients' interests.