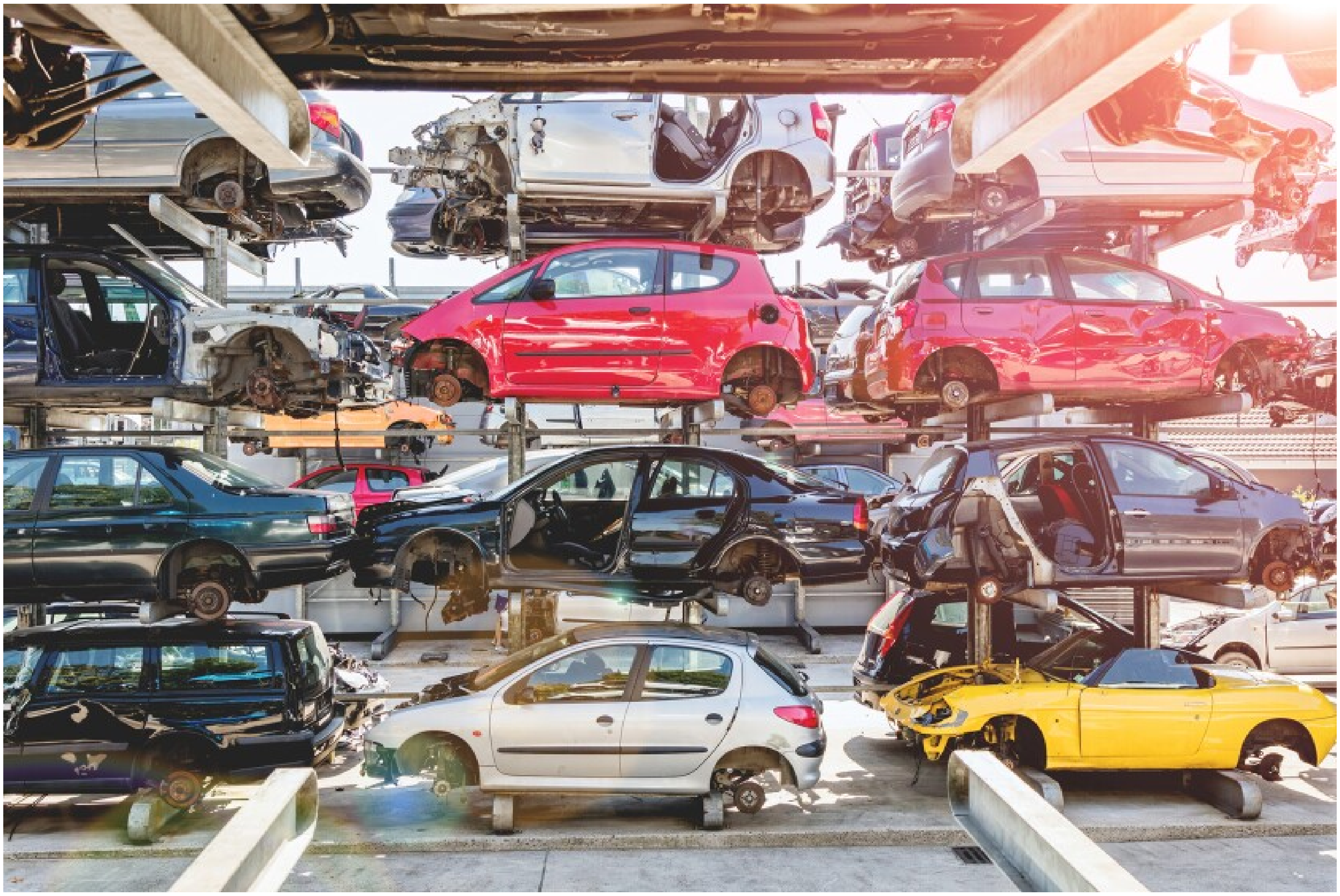
Ritchie-IAA: Reviewing the Twists and Turns



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A deal combining the Canadian live and online equipment and truck marketplace with an auto salvage and parts auction company faced an 'unprecedented' level of support and opposition, both from activists and passive investors.

By Ronald Orol

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On Tuesday, March 14, a slim majority of Ritchie Brothers Auctioneers Inc. (RBA) voting shares approved the company's cash and stock acquisition of IAA Inc. (IAA). The vote brought to a close an unusual months-long drama that included a half-dozen institutions agitating publicly for or against the deal, while at least three activist investors pushed their own agendas on both sides.

"I have never seen so many public players in a deal like this," Alliance Advisors LLC senior vice president Thomas Ball said. "You had activists on the inside wanting to get the deal done and activists on the outside pushing against it. And so many big investors came out for and against it. Unprecedented."

The final vote count isn't yet public, though one large opponent on Friday said that 46% of voting shares were opposed. The investor, Luxor Capital Group LP, made a final push to thwart the transaction on Monday after Ritchie co-founder David Ritchie came out publicly in opposition, though his views didn't change the outcome. According to a person familiar with the situation, some investors revoked their supportive votes in the two days before Tuesday's meeting, after the co-founder revealed his opposition, and only about 50 million shares voted in favor of the merger, or roughly 45% of outstanding shares.

A Look Back

The transaction faced resistance right from the beginning — and actually, even before. Ancora Advisors LLC, a Cleveland-based activist investor, had previously urged IAA, a Westchester, Ill.-based auto salvage and parts auction company, to conduct a sale process, and in November IAA agreed to be sold to Ritchie for $10 a share in cash and 0.58 common shares for each IAA share, valuing the acquisition at $7.3 billion. Ancora, a 4% IAA holder, subsequently agitated for better transaction terms, and Luxor, a 4.2% Ritchie holder, in December launched a campaign against the deal.

Vancouver, British Columbia-based Ritchie, which operates live and online marketplaces for heavy equipment, trucks and other assets, argued the transaction would help diversify its customer base to create a "global marketplace for commercial assets and vehicles." Critics, however, worried the deal would represent a distraction from Ritchie's strategy, as the acquisition was of a company losing market share to its main competitor, Copart Inc. (CPRT).

Nevertheless, to get Ancora's support, on Jan. 23, Ritchie adjusted the terms to include a sweeter $12.80 a share in cash, and a less sweet 0.53 common shares, and it agreed to pay a one-time $1.08 a share dividend to its investors. Ancora, which also obtained a directorship, was on board.

On the same day, Ritchie announced it had accepted a controversial $500 million mostly convertible preferred security infusion from a well-known activist, Starboard Value LP, and the fund's manager, Jeff Smith, gained a seat on the board.

After that, three big investors, typically passive investor Janus Henderson Investors LLC with a 3.44% stake, 1% holder Eminence Capital and 1.7% investor Vontobel Asset Management, issued notes or otherwise came out opposing the deal and the Starboard infusion. (Vontobel would, later in March, reverse its view and support the deal publicly.)

As the deal vote approached, The Deal learned that two big Ritchie investors, Independent Franchise Partners LLP and Eagle Asset Management Inc., with 4.4% and 3% respectively, supported the transaction and Ritchie CEO Ann Fandozzi. (Independent and Eagle also are big IAA holders, owning 4.4% and 1.5%, respectively, of IAA, and as a result likely had a different motivation from investors only holding Ritchie shares.)

Finally, in early March, the two major proxy advisers, Institutional Shareholder Services Inc. and Glass, Lewis & Co. LLC, both issued reports urging investors to reject the deal, a major blow to the transaction and one that led a handful of proxy solicitors contacted soon after by The Deal, including those working on the merger, to seriously doubt whether it would be approved.

"I thought it was over then," one proxy solicitor said.

The proxy advisers raised a number of concerns, including with regard to Starboard's investment. ISS, for example, said that to help fund the Ritchie dividend and adjusted deal, the company issued a "lucrative" convertible security to Starboard, which "drew public opposition."

Luxor pointed out that Ritchie could have sought out cheaper debt financing on better terms, adding that Starboard received many benefits not bestowed on common shareholders, including an overall dividend rate of almost 7%. If the deal didn't go through, the activist would have received a $10 million breakup fee, and Luxor said Starboard would receive more than $90 million if Ritchie were acquired at near current trading levels in the next few years.

Despite the opposition, the deal won shareholder approval, though narrowly. Observers following the situation suggested that in spite of the criticism, the Starboard infusion made sense. Alliance's Ball said it was a "genius" move for Ritchie to accept the investment, despite concerns from some investors about it being overly profitable for Starboard.

"You've got a known activist who is in support of the deal, and that likely eased the concerns of some institutional investors," he said. "This is someone who will look out for their own interest and tangentially for the interest of other shareholders."

That said, Ball said he didn't think the Starboard infusion, often referred to as a white squire investment, will represent the start of a trend for merging companies facing investor dissent.

"It was such an unusual situation, so I don't think we'll see a lot of activists participating like this to help a merger party, because it was such a messy situation," he said.

Waheed Hassan, founder of ZMH Advisors, said that by gaining Starboard's investment, Ritchie management improved the company's defenses against disgruntled investors because the fund represents a big investor block voting for the existing board. According to a January securities filing, Starboard, which has a stake convertible into 3.7% of the combined company, wasn't permitted to vote on the merger, but it agreed for a period of time to not vote against any incumbent company directors.

"Fast forward to next year: If you see cracks in the execution of the merger, and investors want to run a campaign for board seats, [Starboard's] support for the incumbent nominees under the standstill agreement could create a hurdle for the dissident," he said.

Unusual Investor Base

Hassan said a big part of Ritchie's institutional investor base likely either has their own stewardship teams or investment analysts who took the time to review the situation on their own, and they weren't reliant on proxy adviser recommendation reports.

For example, according to ZMH Advisors' engagement dashboard, Massachusetts Financial Services Co., the company's largest holder with a 7% stake, has a policy to have its proxy voting committee consider and vote on "matters that require the particular exercise of discretion" or judgment.

"Proxy advisers are influential but don't determine the outcome in every situation," Hassan said. "It is more important to understand the nuances of how investors evaluate proxy contests and vote on them. According to our dashboard, most Ritchie investors have a 'case by case' approach to evaluating proxy contests, which is why the meeting outcome differed from ISS and Glass Lewis recommendations."

Ball agreed that Ritchie's investor base was unusual and didn't include Blackrock Inc. (BLK) or State Street Corp., two big index fund managers that are typically large investors at most U.S. companies. The other big index fund manager, Vanguard Group Inc., holds 2.7%.

"You have a lot of independent thinkers here who do their own analysis," Ball said. "These investors aren't part of an index, and this clearly is an investment that they know and a sector they know and did their own due diligence on, and they aren't going to automatically follow ISS and Glass Lewis because they have their own teams."

What's Next?

Ritchie may report on a consolidated basis, and as such it may be difficult to untangle Ritchie's positive attributes from any negative IAA issues.

Nevertheless, Starboard's involvement could ultimately represent a double-edged sword for Ritchie. Smith, who has agreed to back incumbent directors for now, noted in a January statement in support of the deal that he was excited to join the combined company's board, as he is a "strong believer" in IAA's fundamentals, market opportunities the transaction creates and Ritchie's "leadership expertise."

Yet if Ritchie-IAA doesn't perform well in the next couple of years, a key question is whether Smith, from his position on the board — or perhaps off of it — will push to replace Fandozzi, as he has successfully ousted CEOs in previous campaigns.

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COMPANIES MENTIONED

Alliance Advisors LLC | Ancora Advisors LLC | Ancora Pharmaceuticals Inc. | BlackRock Global Investors | BlackRock Inc. | Copart Inc. | Edge Asset Management Inc. | Eminence Capital LLC | Glass, Lewis & Co. LLC | Henderson Global Investors Ltd. | IAA Inc. | Independent Franchise Partners LLP | Institutional Shareholder Services Inc. | Luxor Capital Group LP | Massachusetts Financial Services Company | Ritchie Bros. Auctioneers Inc. | Starboard Value LP | State Street Corp. | Vanguard Group Inc. | ZMH Advisors

PEOPLE MENTIONED

Ann Fandozzi | Jeff Smith | Thomas H. Ball III | Waheed Hassan

DEALS MENTIONED

M&A
IAA Inc.: 2022-11-07