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US Tech Takeover

This year has seen a surge in takeover activity in the technology sector on AIM, the London Stock Exchange's junior market, as US firms have sought to take advantage of increased cash reserves and beneficial market conditions to consolidate their position.

While some commentators have focussed on the larger end of the takeover market — major corporations such as AstraZeneca and Balfour Beatty have been the subject of speculation — the small to mid-cap sector is where much of the action has taken place. In the past six months, more than 10 AIM-quoted technology companies have been the subject of takeover bids, with a majority of bidders hailing from North America. These include the £32 million takeover bid by Broadcom Corporation in June this year for wireless specialist Innovision Research & Technology; the acquisition by Constellation Software of health club membership software specialist Gladstone plc for £18.1 million; and the acquisition by private equity group Francisco of Cybit plc for £22.8 million.

Cash Rich

A key reason for the resurgence of North American companies in the takeover arena is the cash reserves accumulated by US large-cap companies following the credit crunch. It is currently estimated

that Apple, Google, Microsoft and Cisco alone are sitting on a cash stockpile of \$147 billion, whilst it has been estimated that non-financial US companies now have a total of \$1.8 trillion in cash.

European Factors

US firms looking to invest in the UK have benefitted from a number of European-specific factors that have made acquisitions of UK tech companies more attractive:

Weaker Pound — US companies have been able to make seemingly generous offers in sterling which, due to the depreciation in the exchange rate, represent good value when converted into US dollars.

Discounted EU Markets — for a variety of reasons, many consider that European tech stocks generally trade at a 25-35 per cent discount to their US peers.

Post Credit Crunch Valuation — despite AIM's recent rally, European markets have yet to recover fully from the effects of the credit crunch and as such many securities are undervalued on traditional models.

Commercial Viability — with the recent advent of the iPhone, Bluetooth and various other technological platforms, there are more opportunities for

tech companies to be immediately accretive and profitable.

Potential Protectionism — in the wake of the credit crunch and criticisms of the well-publicised takeover of Cadbury, the Takeover Panel, which applies the City Code on Takeovers and Mergers (the “Code”) that governs takeovers of public companies incorporated in the UK, is reviewing certain aspects of the regulation of takeover bids. Various industry representatives and Government departments have made submissions to the Takeover Panel, including (i) requiring approval by the bidder’s shareholders as a condition to a takeover, regardless of whether the bidder is domiciled in the UK; (ii) increasing “merger fees”; (iii) increasing the approval threshold for the takeover from a simple majority of the target’s shareholders to a two-thirds majority; and (iv) preventing shareholders who acquire shares in the target during the offer period from voting on the takeover. Although it is currently considered unlikely that this review will result in major changes to the Code, the potential for the introduction of protectionist legislation may have encouraged buyers to accelerate their activity before such plans could crystallise.

Regulatory Framework

The UK regulatory framework enables companies and their shareholders to keep track of any substantial fluctuations in shareholdings which may indicate an intention to launch a takeover bid.

In particular, companies with a listing on a UK capital market are required to comply with Rule 5 of the Disclosure

and Transparency Rules, which states that a shareholder must notify the company of the percentage of voting rights he holds either directly or indirectly if the percentage of voting rights reaches, exceeds or falls below certain percentage thresholds (in the case of UK issuers, 3 per cent or any 1 per cent threshold thereafter; and, in the case of non-UK issuers, 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent and 75 per cent). As a result, it is difficult for a prospective bidder to covertly build a stake prior to a takeover, and a degree of publicity is inevitable.

In addition, any takeover of a public company incorporated in the UK will be subject to the provisions of the Code. The Code comprises seven general principles — designed to ensure the fair and equal treatment of shareholders — which are then expanded upon by detailed rules.

A key theme in the Code is ensuring that all shareholders receive adequate information in a timely manner. The Code therefore requires a takeover target or its prospective bidder to make an announcement of the proposed offer as soon as a firm intention to make an offer is notified to the board of the target company from a serious source and then at certain other important stages in a takeover. This provides transparency in the market and is intended to ensure equality of treatment for all shareholders.

The Code also provides that if the bidder either acquires shares resulting in a stake of 30 per cent or more of the voting rights in the target company or is already interested in between 30 per

cent and 50 per cent of the voting rights, and acquires any other voting shares, it must make a mandatory offer to acquire all the equity share capital of that company that carry voting rights.

There are also requirements in the Code in relation to the form and level of consideration that must be offered — the price of any offer must be no less than the highest price per share paid by the bidder in the previous three months and the Code specifies certain situations in which an offer must be made in either cash or securities (generally where the bidder has acquired shares in the target on such a basis before making the offer).

Unlike in the US, where a range of both pre-emptive and responsive defences are available to target firms, the Code restricts the ability of the target’s board to take steps to defend itself against the bid, unless the target’s shareholders have approved such action.

As well as the Code, there may be other national and European legislation that may be relevant to a takeover. In particular, European competition law may affect a bidder’s ability to acquire a target: if the merger may result in a concentration that is incompatible with the common market, it will need to be notified to the European Commission. However, few tech companies on AIM are likely to have a sufficient European market share to trigger the relevant thresholds. Nevertheless, potential bidders should be mindful that the approval of national regulators such as the UK Office of Fair Trading and the German Bundeskartellamt may be required where domestic competition is affected by the takeover.

Conclusion

Many US companies currently have significant cash resources and tech companies on AIM have provided attractive acquisition targets for the various reasons outlined above. However, with continued economic uncertainty, both in the US and internationally, it remains to be

seen whether this will turn into a sustainable trend or US companies will begin to take a more cautious approach with their cash resources.

How We Can Help

Hunton & Williams' London office has extensive experience in the regulation of AIM-listed companies and public

company takeovers, having acting on more than 90 AIM transactions in the last five years. The office was recently listed in the Top 10 law firms based upon number of AIM clients. If you would like to discuss any of the issues raised in this note, please contact [Raúl Grable](#), [James Green](#) or [Christopher Raggett](#).

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