Internet Appendix to

Are Target Shareholders Systematically Exploited in Management Buyouts and Freezeouts?

A.1. Case-based examples of MBOs and freezeouts

In the main body of the paper, we observe that on average industry peers of target firms earn significant positive abnormal returns over the twelve months following MBOs and freezeouts. We further document evidence that is consistent with managers and controlling shareholders exploiting outside shareholders in the deals. The results indicate systematic industry-wide undervaluation at the time of the *average* buyout or freezeout. As discussed in Sections 2 and 5.4 of the paper, it is legitimate for researchers to draw inferences about the *average* deal from statistical tests based on a large sample of acquisitions.

However, for a *specific* deal, it is difficult for investors or attorneys to convince the judge of undervaluation given a sample of one and large variations in post-deal industry returns. Below, we present case-based examples of specific deals in addition to the MBO of Dell in 2013 in the Appendix to the paper to highlight this difficulty facing investors. Although the target's industry peers experienced positive and large returns over the year following many deals, industry values dramatically decreased following other deals. First, we present one additional example of an MBO and two examples of freezeouts. For each pair of deals (including the MBO of Dell presented in the Appendix), the target industry peers experienced similar pre-announcement returns, but significantly different post-announcement returns. The examples suggest that outside shareholders may have difficulty in identifying industry undervaluation around a given deal ex ante. We also provide particular details on shareholder litigations for these deals. This allows us to demonstrate why litigation and procedural safeguards such as special committees and third-party fairness opinions may not perfectly prevent the exploitation of outside shareholders in MBOs and freezeouts. Where not directly cited, information on respective deals was obtained through company press releases and SEC filings.

A.1.1. MBO of Sierracin, 1989

On April 10, 1989, a group led by Sierracin Corp.'s Chairman announced it would take the aerospace-parts company private in a management buyout. In the 12 months prior to the acquisition, Sierracin's industry peers experienced returns nearly identical to those that preceded the Dell buyout detailed above (9% average industry returns and a 17% market return). Sierracin had an average returns correlation of 0.27 with its industry peers in the preceding 5 years. The $30 million ($15 per share) acquisition for the 50% of the company the group did not own, was approved by the board of directors at Sierracin in August. However, the deal was contingent on approval of the majority of minority shareholders and the settlement of shareholder litigation (filed in 1987, and not directly related to the deal) alleging fraud and mismanagement. Following the approval of the deal by shareholders and approval of the settlement by the Delaware Chancery Court (which agreed that acquisition fairly compensated them for previous damages), the deal was completed. Despite mirroring the industry returns of Dell (presented in the Appendix in the paper) prior to the deal announcement, in the 12 months following the announcement, Sierracin's average industry peer lost 22% of its value, while the market improved (by around 8%) over the same period.

A.1.2. Freezeout of Sandata Technologies, 2002

On September 3, 2002, Sandata Technologies, an IT service provider, announced that it had accepted an offer to be taken private by Sandata Acquisition Corp, 70% owners of the shares outstanding of the firm, for $1.91 per share. The bid price represented a 50% premium over the pre-announcement price. The firm appointed a special committee that, along with the appointed financial advisor, recommended the deal to shareholders, who voted in favor of the deal. Sandata had an average returns correlation of 0.19 with its industry peers over the preceding 5 years. The industry experienced poor returns in the previous 12 months (-34%). Despite this and the size of the premium, two class-action lawsuits were filed against the firm citing a breach in fiduciary duties.[1] To settle the lawsuits and move ahead with the deal, Sandata Acquisition Corp increased its bid by 16% to $2.21 per share, and the deal was completed, representing roughly a 74% increase from the pre-announcement price. However, in the 12 months following the deal announcement, Sandata's industry peers outpaced this large premium, gaining nearly 128%.

A.1.3. Freezeout of Cox Communications, 2004

On August 1, 2004, Cox Enterprises submitted a proposal to acquire the 38% of Cox Communications (a cable television and telecommunications provider) it did not own and take the company private for $32 per share, representing a 16% premium on the pre-announcement price.[2] Similar to the Sandata freezeout discussed above, in the year prior to the announcement, Cox Communication's industry peers had performed poorly. Specifically, Cox's industry had an average loss of 10% while the market gained around 13% during the same period. In the previous 5 years, the average returns correlation between Cox and its industry peers was 0.30. Following the proposal, the board appointed a special committee to evaluate the proposal. However, even prior to this time several lawsuits were filed challenging the deal under the entire fairness standard (discussed in Section 2). The special committee negotiated an increase of the offer price to $34.75 per share with Cox Enterprises, contingent on the approval of the deal by

[1] See the court filings for *Seitler v. Sandata Technologies, Inc., et al.* and *Yetzer v. Sandata Technologies, Inc., et al.*
[2] Information for this section was taken from Berman and Grant (2004) and the court filing *In Re Cox Communications, Inc. Shareholder Litigation*.

the majority of the minority and the resolution of outstanding lawsuits. Additionally, Cox Enterprises agreed to pay attorneys fees for the litigants of up to $4.95 million. Under these circumstances Vice Chancellor Leo E. Strine, Jr. reduced the attorney's fees payable to litigants, generally challenged non-meritorious litigation, and discussed the problems of a non-unified framework for assessing different forms of freezeouts (as discussed in Section 2, this was not changed until *Kahn v. M&F Worldwide* in 2014). Despite this favorable outcome for the firm and in contrast to the outcome of the Sandata frezeout, in the year following the announcement of the acquisition, Cox Communication's industry peers experienced negative returns on average (-8.5%), while the market had positive returns of 15% over the same period.

Table A1 summarizes the pre- and post-event returns to emphasize how difficult it would be in an individual case to know or successfully litigate that the target was being undervalued.

A.2. Additional case-based examples of MBOs and freezeouts

For the benefit of the interested reader, we now present additional examples of MBOs and freezeouts to further highlight the challenge facing investors and courts in establishing undervaluation in a specific deal as well as further examples of litigation in these types of deals.

Table A1

Summary of industry returns around two MBOs and two freezeouts.

For each deal we compute the average stock return correlation between the target and its individual industry peers over the 60 months before the deal, the average 12-month buy-and-hold returns to its individual industry peers, and the average 12-month market returns, and present the deal-level summary statistics in the table below. Monthly market returns are retrieved from Kenneth French's website. We require at least five months of stock returns when calculating the stock return correlations. We truncate the 12-month buy-and-hold returns to individual industry peers and the corresponding 12-month market returns if the industry peers do not have available returns in the CRSP database throughout the first 12 months after the deal or throughout the 12 months before the deal.

Target Name	Deal Type	Correlation	Industry Return Pre-Deal	Mkt-Adjusted Industry Return Pre-Deal	Industry Return Post-Deal	Mkt-Adjusted Industry Return Post-Deal
Dell	MBO	0.35	9%	-8%	38%	10%
Sierracin	MBO	0.27	9%	-8%	-22%	-30%
Sandata Technologies	Freezeout	0.19	-34%	-18%	128%	104%
Cox Communications	Freezeout	0.30	-10%	-23%	-9%	-24%

A.2.1. MBO of Kenneth Cole Productions, 2012

On February 23, 2012, Kenneth Cole Productions (KCP), a footwear, clothing, and apparel designer and retailer, announced that its board of directors has received a proposal from Kenneth Cole, Chairman and Chief Creative Officer of KCP, to acquire all of the outstanding shares of KCP's common stock that he does not currently directly or indirectly own for $15.00 per share in cash, valuing the company at $280 million.[3] The board formed a special committee to evaluate the deal and eventually a final price of $15.25 per share was agreed upon, representing a 17% premium over the stock price the day before the announcement. While over the previous year KCP's industry peers (with which it had an average returns correlation of 0.40 over the past 5 years) had experienced positive returns (27%) in excess of the market (3%) and positive 3rd quarter 2011 financial results, the industry had generally performed poorly during the financial crisis.

[3] Information for this section was taken from Roose (2012) and the court filing *In the Matter of Kenneth Cole Productions, Inc., Shareholder Litigation*.

Despite the majority (over 99%) of shareholders voting in favor of the deal, several shareholders brought litigation against the firm for damages due to a breach in fiduciary duty on the part of the special committee and board of directors. Even though KCP's industry peers had positive returns prior to the buyout announcement, they experienced flat returns (around 3%) in the 12 months following the announcement, which were lower than the market return over the same period (13%). The litigation was dismissed and held up on appeal, leading to the ruling discussed in Section 2 of the paper (*In the Matter of Kenneth Cole Productions, Inc., Shareholder Litigation*), which applied a unified standard to such deals.

A.2.2. MBO of Solomon-Page Group, 2000

On March 31, 2000, after a unanimous vote of its board of directors, Solomon-Page Group, a provider of staffing services, announced that it had agreed to be acquired by a management group for $4.25 per share, which represents a 49% premium over the pre-announcement price. This announcement came following the recommendation of the special committee as well as the company's financial advisor. In the previous 12 months, both Solomon-Page's industry peers and the market had performed well with returns of 23% and 22%, respectively. Solomon-Page had an average returns correlation of 0.19 with its industry peers over the 5 years prior to the announcement. Shortly after the announced deal, a shareholder filed a class-action lawsuit against Solomon-Page, citing a breach in fiduciary duty.[4] As a result of the settlement of this lawsuit, the offer price was increased to $5.25 per share and the management group agreed to a super-majority of shareholders to approve the acquisition. Following another recommendation by the special committee and fairness opinion by the financial advisor, a super-majority of shareholders approved the acquisition and the deal was completed. In the 12 months

[4] See the court filing, *In re Straub v. Solomon-Page Group Ltd.*

following the acquisitions announcement, however, Solomon-Page's industry peers lost significant value, with the average firm experiencing returns of over -50%.

A.2.3. MBO of Gleason, 1999

On December 9, 1999, Gleason Corporation, a maker of gear-production machinery and related equipment, announced that it had agreed to be acquired by the firm's Chairman and CEO, James S. Gleason, other senior management, and the private equity firm Vestar Capital Partners for $23.00 per share. The offer price represented a 28% premium over the pre-announcement price. In the year prior to the announcement, Gleason's industry peers had experienced negative returns (-4%), while the market had increased in value over the same period (23%). In the previous 5 years, Gleason had shared an average returns correlation of around 0.25 with its industry peers. A special committee of the board of directors had unanimously recommended the deal, following the recommendation of the committee's independent financial advisor, Bear Stearns. We are unable to find any evidence of shareholder litigation for this deal. In the 12 months following the announcement of the deal, Gleason's industry peers had a significant turnaround with average returns of over 55%, during a period when the market lost 11%.

A.2.4. Freezeout of Pacific Telecom, 1994

On November 1, 1994, Pacific Telecom announced that Pacificorp offered to acquire the remaining 13% of Pacific Telecom that it did not already own for $28.00 per share, representing a 15% premium over the pre-announcement price. Additionally, over the previous 12 months, Pacific Telecom's industry peers had experienced slightly negative returns of about -2%, and in the previous 5 years the average returns correlation between Pacific Telecom and its industry peers was 0.24. Immediately after the announcement, a class-action lawsuit was filed citing a breach in fiduciary duty. However, shortly after the lawsuit was dismissed. A special committee was appointed and negotiated an increase in the offer price to $30 per share. Following the recommendation of the special committee and an independent financial advisor, the majority of minority shareholders voted in favor of the acquisition and the deal was completed. In the year following the announcement, Pacific Telecom's industry peers experienced an average increase in value of over 40%.

A.2.5. MBO of Hospital Corp of America, 1988

On September 15, 1988, Hospital Corp of America, the nation's largest hospital chain at the time, announced that a management-led group, including the Chairman and CEO Thomas F. Frist, Jr., had offered to acquire the company for $47 per share, representing a 27% premium over the pre-announcement price.[5] In the 12 months preceding the announcement, Hospital Corp's industry peers, and the market in general, had experienced negative returns of -19% and -17%, respectively. In the previous 5 years, the average returns correlation between Hospital Corp and its industry peers was 0.49. Following the offer, on the advice of an independent financial advisor, independent members of the board negotiated for an increase in the offer to $51 per share, including $43 per share in cash, $4.17 per share in preferred stock, and junk bonds valued at $3.83 per share. Some shareholders filed a class-action lawsuit that cited a breach in fiduciary duties and previous insider trading, which was subsequently dismissed in Tennessee courts. Shareholders approved the deal in early 1989. In the year following the announcement, Hospital Corp's industry peers dramatically increased in value by 44%. Additionally, Hospital Corp performed well under private ownership and subsequently went public again in 1991.

A.2.6. MBO/Freezeout of Malrite Communications, 1988

[5] Information for this section was taken from Freudenheim (1988) as well as the company's press releases and SEC filings.

On August 15, 1988, Malrite Communications Group, a broadcasting company that owned several radio and television stations across the United States, announced that it had received a buyout offer from a management group led by the company's founder, Chairman, and CEO, Milton Maltz.[6] The bidders offered $10.25 per share in cash, representing a 46% and 28% premium over the pre-announcement price of Malrite's Class A and common stock, respectively. In the previous year, stock prices of peer firms in Malrite's industry had dropped by nearly 20% on average, and Malrite had posted a net margin of -7%. The average returns correlation between Malrite and its industry peers was nearly 0.45.

Nevertheless, several outside analysts felt that Malrite was undervalued. For example, Kenneth Berents of Butcher & Singer stated that "a lot of shareholders thought the company was worth a lot more – $15, $16, even $17 a share, but Milton Maltz controls the company, and there's not much they can do about it" (Siler, 1988). Roughly consistent with this notion, the independent board member and the independent financial advisor found the initial offer, and a subsequent $11 per share offer as too low. However, the board member and financial advisor both recommended a revised bid of $11.142 per share in cash. Another analyst described the deal as an example of "the leverage that a management with majority control has over minority shareholders" (Fabrikant, 1989). We were unable to find any evidence of any shareholder litigation in response to this case. In the year following the acquisition announcement, Malrite's industry peers made significant gains in value, with the average peer earning nearly 95%.

[6] Information for this section comes from Siler (1988) and Fabrikant (1989).

References:

Berman, D., Grant, P., 2004. Cox family to take firm private. The Wall Street Journal (August 2, 2004).

Fabrikant, G., 1989. Malrite's buyout price disturbs Wall Street analysts. The New York Times, The Media Business (March 6, 1989).

Freudenheim, M., 1988. Buyout set for chain of hospitals. The New York Times (November 22, 1988).

Hoffman, L., 2016. Judge finds Michael Dell, Silver Lake underpaid for Dell in 2013. The Wall Street Journal (June 1, 2016).

Jiang, W., Li, T., Mei, D., Thomas, R., 2016. Reforming the Delaware Appraisal Statute to address appraisal arbitrage. Will it be successful? Unpublished working paper. Columbia Business School.

Parloff, R., 2016. How Michael Dell shortchanged shareholders while doing nothing wrong. Fortune (June 2, 2016).

Roose, K., 2012. Kenneth Cole offers to take his company private. The New York Times, Dealbook (February 24, 2012).

Siler, J., 1988. Malrite executives offer buyout at $10.25 per share. The New York Times, The Media Business (August 16, 1988).