

Telco Takeover Bid

In mid-August 2001, the Localville Telco board rejected an unsolicited \$6 billion offer for the company from rival telecommunications operator, Expander Telco. The companies are relatively small but profitable players in the huge US market. Both companies specialize in providing services to rural areas that have so far avoided the attentions of the giants. Localville's rejection of the offer is not the end of the matter. Expander's \$43-per-share offer is more than 40% above Localville's pre-bid share price of around \$30.

Localville grew from small beginnings under the care of current Chairman, Augustus Lovett, who has headed the company for several decades and remains a substantial shareholder. The company's managers and employees (including Chairman Lovett) between them own 30% of Localville's voting stock and, of the 14 board members, five are current or former employees. Localville is based in a small rural town and many of its 7,000 employees live in the area and take pride in participating in community affairs. Chairman Lovett has served as mayor and has sat on local community boards over the years. A takeover by Expander would lead to major layoffs in a community that has benefited from several generations of employment at Localville.

Expander's annual turnover of \$7.5 billion is three times that of Localville at \$2.5 billion. Although the companies both offer local (landline or wireline) and mobile (wireless or cell-phone) phone services, their service mixes are quite different. Expander has 6.7 million mobile and 2.6 million landline customers, while Localville has 0.8 million mobile and 1.8 million landline customers. Through an arrangement with one of the industry giants, Expander provides national roaming (mobile customers can make and receive calls from anywhere in the US) and can provide flat-rate national calling to mobile customers at cost. Expander has mobile penetration averaging 13% across its territories, and achieves a 61% margin on its mobile operations. Localville does not have a national roaming arrangement, its penetration is less than 10%, its margin is 54%, and its mobile revenues are flat — falling nearly 1.5% in the second quarter. In fact, shortly before Expander made its offer to buy Localville, Localville had approached Expander to assess the rival company's interest in purchasing Localville's mobile operation. Expander rejected the proposition, as company policy is to offer a comprehensive service, including local calls, when moving into a new territory.

Expander's father and son team, Chairman Al Exley and CEO Brad Exley, have acquired more than 250 companies over the last 15 years, and have spent \$12 billion on acquisitions during the last three. Localville's footprint (the geographical spread of its customers and potential customers) complements Expander's. Expander's analysis suggests that economies of scale resulting from the purchase of Localville should amount to \$100 million (1%) on combined revenue of \$10 billion. There would be further gains from lifting the financial performance of Localville operations to the levels achieved by the current Expander operations. As well as these advantages, in the longer term the enlarged Expander may present an attractive acquisition for a major operator willing to pay a premium in order to gain a regional customer base.

Localville has told analysts that the company doesn't need to sell-out to Expander in order to provide a good return to shareholders. Localville maintains that revenue growth from the company's landline business will exceed that of Expander. Nevertheless, the prospects for the mobile side of Localville's business — responsible for roughly 20% of revenue — concerns shareholders. Without national roaming agreements, Localville can't offer the cheap flat-rate national calling deals that customers are increasingly demanding. Localville's strategy of selling the mobile operation and expanding the business as a landline operator is considered by some analysts to offer the best deal for shareholders. The Localville board are adamant that the company is happy to talk to Expander only about selling its mobile operation. It is unlikely that the board could be forced to change its stance by non-employee shareholders who are keen to accept Expander's offer: Localville doesn't have to hold a shareholder meeting for another three months and company rules make it impossible to oust the whole board at one time. Although it is possible under US law to bypass the company board and make an offer directly to shareholders, the process is restricted by regulation and, even if Expander acquired more than 50% of Localville stock, the current board could remain in effective control of the company for some time. Localville released the following statement on mobile services: "...divestiture efforts have been adversely affected by a hostile takeover attempt... and a recent sharp decline in the general mobile market... we continue to believe that divestiture makes strategic sense and we continue to pursue that goal. Nevertheless, mobile generates strong cash flows for Localville and so we do not feel compelled to divest until we are presented with the right offer".

It is now September, 2001. Despite Localville's rejection, Expander hasn't given up on buying the Localville company. Expander knew that the Localville board was not interested in selling the whole company when it first made its bid. Institutional investors and other non-employee shareholders of Localville are not happy with the board's rejection of Expander's offer and this has put pressure on Localville management to find a credible solution to the companies current performance woes. The stand-off between Expander and Localville must be resolved. In which one of the following four ways will this happen?

1. Expander's takeover bid fails completely
2. Expander purchases Localville's mobile operation only
3. Expander's takeover succeeds at, or close to, their August 14 offer price of \$43-per-share
4. Expander's takeover succeeds at a substantial premium over the August 14 offer price

Role of Localville Telco Chairman – Augustus Lovett

Several decades ago you became Chairman of Localville, a small telephone company founded by your grandfather. Since then you have built the company into a \$US 2.5 billion business. Despite the substantial size of the business, the company head office and many employees remain in the small town where you live and where the company had its beginnings.

Although Localville offers both local and mobile telephone services, mobile users have come to expect to be able to use their phones anywhere in the US for the same (cheap) rate. Localville has not been able to obtain a roaming agreement with one of the major telecommunications companies that would allow the company to offer this service. Recently, Localville approached Expander Telco to explore the possibility of selling Localville's mobile business to Expander. Expander rejected this idea, and offered to buy the whole of Localville. You and the board do not wish to sell the whole business as you believe Localville can do better for shareholders as a provider of local telephone services and, at the same time, protect your employees and the local community. Not all shareholders agree, however, and you and your CEO, Bill Lowe, have a tough fight on your hands to keep Localville safe from Expander's hostile takeover bid.

Role of Localville Telco CEO – Bill Lowe

Localville is small (by US standards) telephone company with a turnover of \$US 2.5 billion. Localville offers both local and mobile telephone services, but mobile users have come to expect to be able to use their phones anywhere in the US for the same (cheap) rate. Localville has not been able to obtain a roaming agreement with one of the major telecommunications companies that would allow the company to offer this service. Recently, Localville approached Expander Telco to explore the possibility of selling Localville's mobile business to Expander. Expander rejected this idea, and instead offered to buy the whole of Localville. The Localville board does not wish to sell the whole business as the directors believe Localville can do better for shareholders as a provider of local telephone services and, at the same time, protect Localville employees and the local community. Not all shareholders agree, however, and you and your Chairman, Augustus Lovett, have a tough fight on your hands to keep Localville safe from Expander's hostile takeover bid. In common with many employees, you own shares in Localville.

Role of Expander Telco Chairman – Al Exley

Under your leadership for the past 15 years, telephone company Expander has grown rapidly with the acquisition of more than 250 companies. Recently, Expander was approached by Localville Telco. Localville wished to explore the possibility of selling its mobile phone business to Expander. You rejected the proposition, as Expander's policy is to be able to offer local telephone services as well as mobile when it moves into a new territory. Localville as a whole, however, would be an attractive acquisition (the companies' territories are complementary) and Expander has offered to buy Localville at a price-per-share that was 40% higher than the price prevailing at the time of the offer. So far, the Localville board has rejected this offer, but you and your son (Expander CEO, Brad Exley) believe Localville is a prize worth fighting for.

Role of Expander Telco CEO – Brad Exley

Under the leadership of your father (Chairman Al Exley) for the past 15 years, telephone company Expander has grown rapidly with the acquisition of more than 250 companies. Recently, Expander was approached by Localville Telco. Localville wished to explore the possibility of selling its mobile phone business to Expander. Expander rejected the proposition, as company policy is to be able to offer local telephone services as well as mobile when it moves into a new territory. Localville as a whole, however, would be an attractive acquisition (the companies' territories are complementary) and Expander has offered to buy Localville at a price-per-share that was 40% higher than the price prevailing at the time of the offer. So far, the Localville board has rejected this offer, but you and your father believe Localville is a prize worth fighting for.

Telco Takeover Bid

- 1) **How was the stand-off between Localville and Expander resolved?** *(check one ✓, or %)*
- a. Expander's takeover bid failed completely
 - b. Expander purchased Localville's mobile operation only
 - c. Expander's takeover succeeded at, or close to, their August 14 offer price of \$43-per-share
 - d. Expander's takeover succeeded at a substantial premium over the August 14 offer price
- 2) **Describe how you derived your prediction or, if you have *not* given a prediction, state your reasons:**
-
-
-
-
-
-
-
-
-
-
- 3) **Roughly, how long did you spend on this task?**
{include the time you spent reading the description and instructions} hours
- 4) **How likely is it that taking more time would change your forecast?**
{ 0 = almost no chance (1/100) ... 10 = practically certain (99/100) } 0-10
- 5) **Do you recognise the actual conflict described in this file?** Yes No
If so, please identify it:
- 6) **How many people did you discuss this forecasting problem with?** people
- 7) **Roughly, how many years have you spent as a game theory practitioner or researcher?**
 years
- 8) **Please rate your experience (out of 10) with conflicts similar to this one** 0-10

When you have completed this questionnaire, please return
either this document as an email attachment to kesten.green@vuw.ac.nz
or this questionnaire (with your initials at right) by fax to (64 4) 499 2080. **Your initials:**