



## **The flotation of Aer Lingus PLC, Ryanair PLC's subsequent takeover bid and their practical relevance to Financial Management.**

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### **Objective**

The objective of the article is to relate the practical occurrences in the recent flotation of Aer Lingus PLC and Ryanair PLC's subsequent hostile takeover bid to relevant theoretical areas covered in the Financial Management syllabus.

### **Background**

In July 2006 an Irish Government motion decided to privatise Aer Lingus. The Minister for Transport announced the following outline intentions in relation to the planned flotation:

- The Irish Government would ultimately retain a 25.1% shareholding in Aer Lingus post flotation
- That the Initial Public Offering Prospectus would be available in late summer 2006 with a view to flotation in September/October 2006.

### **Initial Public Offering Process**

On 12<sup>th</sup> September 2006 the Initial Public Offering Prospectus was made publicly available by The Aer Lingus Group PLC in conjunction with its joint sponsors AIB Corporate Finance and UBS Investment Bank.

The essential elements of the document were as follows:

- The flotation would take place on 27<sup>th</sup> September 2006
- The offer price range was between €2.10 and €2.70 per share, valuing Aer Lingus at between €1.1 billion and €1.4 billion. The actual offer price would be announced on 26<sup>th</sup> September 2006.
- A bonus issue would be made of one share for every 20 shares held continuously one year from the date of flotation.
- The minimum subscription was €10,000

Note: It is generally considered that the minimum investment of €10,000 was set with a view to discouraging smaller investors. This was as a result of the losses experienced by many such investors arising from the Telecom Eireann (now Eircom PLC) flotation in 1999.

### **Company Valuation**

The value of Aer Lingus PLC had to be ascertained prior to the announcement of the flotation price. The management of Aer Lingus and their corporate finance advisors were responsible for deciding thereon. In doing so the following valuation bases will have been considered:

- An earnings based approach (recurrent Earnings Per Share \* Price Earnings Multiple)

- Net assets basis (current value of the net assets of Aer Lingus PLC)

It is unlikely that the Dividend Valuation Model would have been used because no past dividends had been paid by the company.

Ultimately, it was decided that the offer price range in the Initial Public Offering Prospectus was to be between €2.10 and €2.70 per share, valuing Aer Lingus at between €1.1 billion and €1.4 billion.

In the speculation prior to the announcement of the offer price the financial press expressed concerns in relation to:

- The record high price of crude oil and the ongoing political and economic volatility in the Middle East.
- The experience of Air Berlin's recent flotation during May 2006 which although delayed was ultimately under-subscribed
- The indicative €336 million funding gap in the Aer Lingus staff pension scheme,

and suggested that a lower price would be advisable to help guarantee a successful flotation.

On 26<sup>th</sup> September the flotation price of €2.20 per share was announced valuing Aer Lingus at €1.13 billion. The market's concerns expressed above were clearly considered in arriving at this offer price. On announcement of the price of €2.20 it was generally considered that it slightly undervalued the company.

### **The Flotation Experience**

On 27<sup>th</sup> September 2006 the flotation took place at an offer price of €2.20. It was a successful flotation in that it was fully subscribed. At the end of trading on 27<sup>th</sup> September the share price had risen to €2.38. There were signs of profit taking, mainly smaller investors realising close to a 10% gain in the first few hours of trading. The graph below shows Aer Lingus PLC's share price movement since flotation.

### **Efficient Market Hypothesis**

Within hours of the flotation the price of Aer Lingus PLC's shares increased to €2.45. This reflects the market's reaction to the generally held view that the offer price of €2.20 slightly undervalued the company.

### **Ryanair PLC's Takeover Bid for Aer Lingus PLC**

On 5<sup>th</sup> October 2006 Ryanair PLC publicly announced outline details of a takeover bid for Aer Lingus PLC. The offer was €2.80 cash for each Aer Lingus PLC share. On announcement of the bid Aer Lingus PLC's shares rose to €2.90. They would close at a high of €2.95 the following day.

At the time of making the bid Ryanair PLC owned 19.2% of Aer Lingus PLC's shares. Ryanair PLC would require a 50.1% majority holding required to take control of the Aer Lingus PLC.

### Conduct of the Takeover Bid

In making the bid Ryanair PLC had to comply with Stock Exchange regulations, The City Code on Mergers and Takeovers. In so complying they had to ensure that:

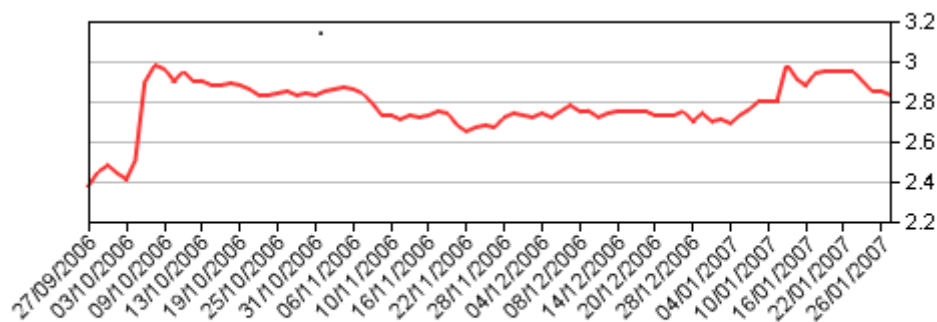
- All shareholders of the same class are treated equally
- All information must be made available to all shareholders.

On 23<sup>rd</sup> October 2006 Ryanair PLC posted its formal offer document to all Aer Lingus PLC shareholders. This document confirmed the precise detail of the bid and described their future strategic intentions for the airline if, their bid was successful. Shareholders had to respond to the offer by 13<sup>th</sup> November 2006.

### Efficient Market Hypothesis

On the 5<sup>th</sup> October 2006, the date on which Ryanair PLC announced outline details of the €2.80 per share bid the price of Aer Lingus PLC shares increased from €2.51 to €2.90, reflecting the market's reaction to the bid. This reaction supports the view that The Irish Stock Exchange displays semi-strong form market efficiency in that the price of any share quoted thereon reflects both:

- All past information pertaining to a share's valuation, plus
- All publicly available information pertinent to a share's valuation, and that insider information is not a recurring feature of The Irish Stock Exchange.



### Hostile Takeover Bid

As the management of Aer Lingus PLC were not in favour of Ryanair PLCs takeover it was considered a hostile takeover bid. However, given that the ownership of Aer Lingus PLC is now in public hands its management team could not attempt to frustrate the bid unduly and had to act in an impartial manner. In essence, as the target company they had to comply with The City Code, which ensures, amongst many things, that the shareholders decide for themselves whether or not to accept the proposed offer.

### Defence against Ryanair PLCs Hostile Bid

On 3<sup>rd</sup> November 2006 the management team of Aer Lingus PLC issued a document to its shareholders in which it:

- Promoted the capability of Aer Lingus PLCs management team and staff
- Reiterated their strategic intentions for the company.

It stated that Ryanair PLC's bid "significantly undervalues the group's businesses and its attractive long term growth potential"

In another defensive move to help further frustrate the proposed bid it was referred to The European Commission. It argued that the proposed takeover would significantly reduce competition for air travellers throughout the island of Ireland, and thus, should be considered anti-competitive and blocked by The Commission. The Commission's opinion is expected to be delivered in Summer 2007.

These steps are legitimate defences against what Aer Lingus PLC's management viewed as a hostile takeover bid.

In the financial press of the time it was generally agreed that The Irish Government and The Employee Share Ownership Trust (ESOT) which at the time of the bid held 28% and 13% of Aer Lingus PLC shares respectively were, for various reasons not in favour of the Ryanair PLC's bid. There were also a number of high profile shareholder groups who publicly rejected the bid including The Irish Air Pilots Association which had built up a stake of 2%, as had entrepreneur Denis O'Brien who publicly warned against acceptance of the Ryanair PLC bid.

The general view was that the bid would be unsuccessful in its attempt to gain a majority shareholding in Aer Lingus PLC.

#### **Outcome of the Ryanair PLC's Bid**

On 4<sup>th</sup> November 2006 it was announced by Ryanair PLC that their offer had been accepted by only .1% of Aer Lingus PLC shareholders. They fell significantly short of the 50.1% majority holding required to take control of the Aer Lingus PLC. On announcement of the results of the bid Aer Lingus PLC's share price fell significantly, an indication that the market considered Ryanair PLC's bid to be exhausted.

Ryanair PLC then decided to extend the deadline for acceptance to 22<sup>nd</sup> November 2006.

#### **The Future of the Bid**

At the time of writing this article the takeover bid has lapsed as it has not been accepted by the necessary number of Aer Lingus PLC shareholders. It remains to be seen whether or not Ryanair PLC will make an improved bid in the future.

#### **Web Links**

[www.ise.ie](http://www.ise.ie)

[www.ryanair.com](http://www.ryanair.com)

[www.aerlingus.ie](http://www.aerlingus.ie)

[www.rte.ie/business](http://www.rte.ie/business)