Strategies for Canadian public companies in a COVID-19 volatile marketplace

DENTONS

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The ongoing COVID-19 pandemic continues to create uncertainty for issuers and, in many instances, has caused significant deterioration in their balance sheets, extreme volatility in stock prices and material disruptions to their ongoing business operations. While the situation is rapidly changing, what is clear is that issuers will face unprecedented challenges in the weeks and months ahead and will be required to take rapid steps and make fundamental decisions to ensure they are well positioned to endure this crisis and the ensuing fallout.

This article provides an overview of certain key considerations for boards and management of Canadian public issuers and practical guidance to help navigate the rapidly evolving and difficult environment that issuers face due to COVID-19.

Shareholder activism

Declines in stock prices due to COVID-19 have made many issuers more vulnerable to shareholder activism and hostile attacks, as lower stock prices provide activist investors with the ability to obtain a meaningful ownership position in most issuers at a lower cost than would have been possible before COVID-19 brought stock prices significantly down.

The abandonment of various activist campaigns and pending M&A transactions in the US, Canada and globally following the rapid deterioration of market conditions brought on by COVID-19 suggests that, notwithstanding the potential opportunities for disruption, there may be a limited appetite for full-fledged activist or hostile campaigns in the short term. However, even though a potential activist or hostile bidder may not take any significant actions at this time, depressed stock prices may allow them to accumulate toehold positions now, with the intention of pressing for change once volatility subsides and there is some return to normal market activity and business operations. As such, issuers may wish to develop strategies and take proactive steps now to prepare for the potential emergence of an opportunistic takeover.

Dealing with hostile bids / activist investors

Although each issuer will need to tailor its response to the heightened risk of a hostile takeover bid and/or activist investors to its individual circumstances, certain proactive steps that every issuer should consider to mitigate the risks posed by a hostile takeover bid and/or activist investors include:

- assessing vulnerability to an unsolicited bid and the viability of possible defenses;

- creating a written plan for dealing with the current COVID-19 crisis and its impact on the issuer, and staying current with the evolving legal and regulatory developments;

- ensuring board and management consensus on the issuer's plan to preserve shareholder value during the COVID-19 crisis;
- conducting a review of public disclosure materials and ensuring that the issuer has a comprehensive and compelling response to the COVID-19 crisis;
- ensuring that the issuer is actively engaging with key shareholders, and potentially with other key stakeholders (such as lending syndicates);
- ensuring regular communication with shareholders, which provides a transparent assessment of the current and anticipated future impacts of COVID-19 on the issuer and its business operations;
- monitoring its shareholder base to identify any toehold positions obtained by potential bidders or activists;
- considering weaknesses and potential activist demands, and preparing draft responses with its advisors; and
- adopting or preparing a shareholder rights plan and/or advance notice by-laws.

The sweeping nature of COVID-19's market impact may decrease the ability of an issuer to implement certain traditional defenses to an unsolicited takeover bid or an activist campaign. For example, issuers may have a limited ability to source an alternative transaction (a "white knight") in the event of a hostile bid. Additionally, target boards and their financial advisors may face unusual challenges in valuing the target given the extreme market volatility and uncertainty. Issuers may also face delays in their ability to prepare and issue audited financial statements as scheduled, which may make it more difficult for their financial advisors to issue an inadequacy opinion in the face of a hostile bid. Furthermore, other traditional defensive tactics, such as issuing securities, undertaking a substantial issuer bid, or declaring a special dividend may not be viable options for issuers at this time due to the conditions created by the COVID-19 crisis.

Corporate actions

Dividends and buy-backs

Due to current market and operational uncertainty, issuers are considering how to respond to significant deterioration in their balance sheets and a corresponding lack of access to capital. In assessing capital needs, issuers may wish to re-evaluate dividend and share buy-back programs in order to preserve their liquidity position. Although cutting dividends and scaling back share repurchase programs may traditionally have been negatively received by shareholders, such actions may now be viewed as prudent corporate governance and indicate that an issuer is responding appropriately to unprecedented conditions and taking the necessary steps to preserve cash and provide the issuer with increased flexibility to respond to constantly changing market conditions. Additionally, issuers should take note of CSA Staff Notice 51-306 published on April 3, 2020, which provides that issuers should suspend any normal course issuer bids if they are relying on the blanket relief provided by securities regulatory authorities from the filing deadline requirements for certain continuous disclosure obligations in light of the COVID-19 crisis.

Issuers who do not elect to amend their dividend policy in order to eliminate dividend payments should ensure that they have carefully examined their ability to satisfy the solvency test for the payment of dividends under their governing corporate statute before declaring any future dividends. The rapid deterioration of market conditions will make it difficult for certain issuers to satisfy the applicable solvency requirements for the declaration and payment of dividends, which may not have been the case prior to the COVID-19 crisis. Therefore, careful consideration should be given to any amendments that may be required to an issuer's dividend policy.

Access to capital

Due to increasing market uncertainty from the COVID-19 crisis and the corresponding detrimental impact on the financial position and operations of many issuers, traditional sources of capital or financing may not be available or may only be available on unfavourable terms. As financial institutions and investors re-evaluate their own operations and risk tolerance, many issuer's will likely find that bank financing is more difficult to source and depressed equity valuations and market turmoil will make capital raises challenging or potentially untenable at this time.

Reports show that Canadian issuers have begun to draw down on their credit facilities as proactive measures in light of the COVID-19 crisis. Access to liquid capital will be a critical lifeline for many issuers in order to prevent cash shortfalls as cash from operating activities dries up. Issuers may wish to engage their legal counsel now (and in advance of any future need to further draw on credit lines) to confirm whether there are any financial covenants or other terms of which the issuer may potentially be offside and may restrict the ability of the issuer to draw down on the facility in the future.

Issuers may also wish to qualify a base-shelf prospectus in anticipation of a potential future at-the-market (ATM) offering and to provide the issuer with the necessary flexibility to move quickly to raise capital if market conditions become more favourable. In order to prepare for an ATM offering, an issuer typically enters into a distribution agreement with a registered dealer to sell debt and/or equity in the market on the issuer's behalf (and the issuer must take certain other steps required under securities legislation in regards to a distribution of securities). The distribution agreement does not obligate the issuer to sell any securities unlike an underwriting agreement in a "bought deal" offering. An ATM offering allows the issuer to control when the securities are sold, the number of securities sold and to specify a minimum price for any sale (as the securities are sold into the market in a manner similar to a brokerage transaction). Additionally, unlike certain other traditional methods of raising capital, an ATM offering will not require management to undertake a "road show" and will allow management to focus their efforts on other matters required to survive the COVID-19 crisis.

While an ATM offering may not be suitable for an issuer looking to undertake a significant capital raise due to restrictions on the number of securities that may be sold pursuant to an ATM offering, it does provide much needed flexibility for issuers to raise or issue debt and/or equity during the challenging market conditions brought on by COVID-19.

Repricing stock options

Due to the negative impact of COVID-19 on stock prices, many executives and employees of Canadian issuers hold stock options that are "out of the money" and have exercise prices that are significantly greater than the current market price of the issuer's stock. These "out of the money" options cannot fulfill their intended purpose if there is no realistic prospect of being "in the money" in the near future and effectively results in the nullification of a major component of most executive compensation plans.

Retention of key executives and employees will be critical for issuers hoping to emerge from this crisis in a position to resume normal operations rapidly once the crisis subsides. Issuers should ensure that they have examined the compensation structure for their key executives and employees to ensure they are properly incentivized.

Issuers wishing to retain key personnel through the current crisis or wishing re-incentivize them in the coming months may wish to reprice currently issued stock options so they are exercisable at prices more in line with current market prices. While there are several methods an issuer can take to restore the intended purpose of stock options issued to management and employees, the most applicable alternative in light of current circumstances would be option repricing or an option-for-option exchange. The specific requirements for repricing stock options (including an option-for-option exchange) will depend on the approach taken, the terms of the stock option plan currently in place and the stock exchange on which the issuer's securities are listed. In most cases, particularly where directors or officers of the issuer hold the options being repriced, the issuer will need: (i) approval of the applicable exchange on which the underlying securities are listed; and (ii) disinterested shareholder approval.

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