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Sovereign Food Investments: Astral back to its nest

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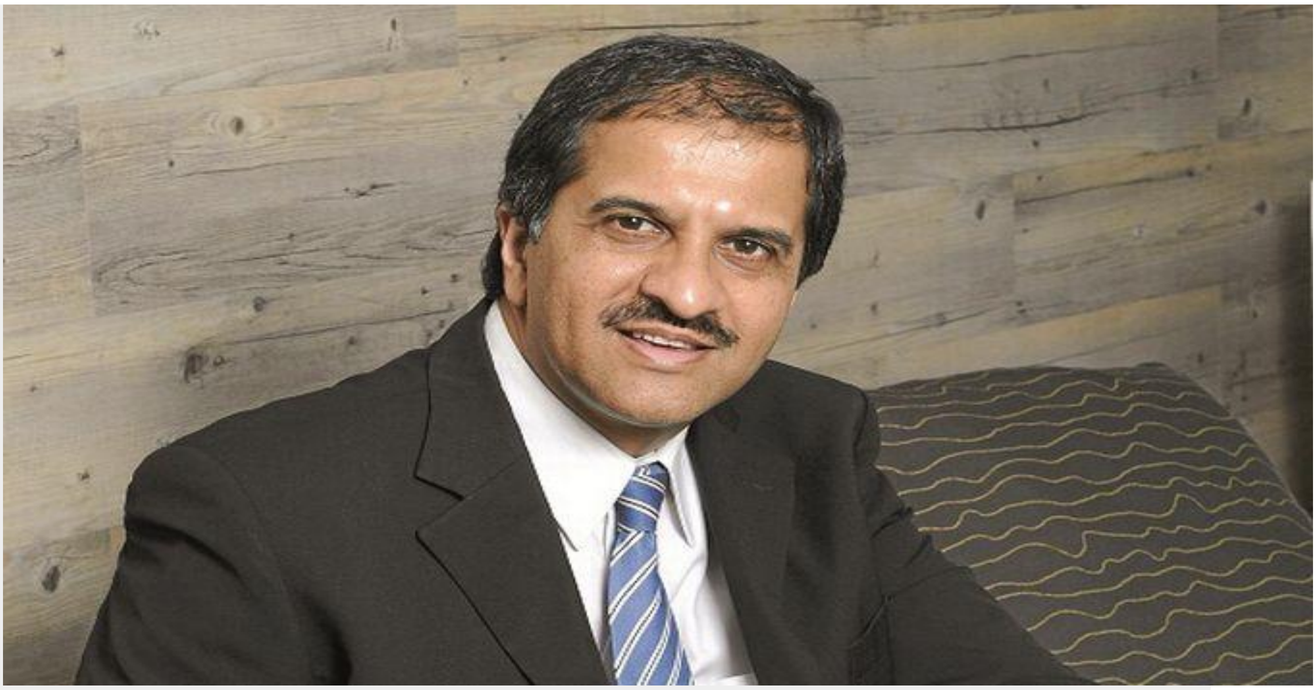

Asief Mohamed: If the performance measure had not changed there would not have been any short-term incentives payable. Picture: HETTY ZANTMAN

DIRECTORS of Sovereign Food Investments deny it, but the company is adopting an empowerment scheme to ward off takeover attempts by larger poultry rivals. In creating this "friendly" voting block with management participation, Sovereign has the support of influential institutional investors Prudential, Sanlam and Old Mutual.

In addition, the JSE's "big bird", Astral Foods, which recently indicated a willingness to play a lead role in consolidating the big six players in the local poultry sector, appears to have retreated.

It says it has not made any offer or entered into any negotiations with any poultry producers or their shareholders. Though it will continue to explore strategic alternatives, its cautionary notice has been lifted.

But it seems unlikely that Astral is not keeping a beady eye on developments at Sovereign, especially since the latter's share price has drifted down more than 15% in the past three weeks and now offers a discount of more than 30% on its last stated tangible net asset value (NAV).

The market, no doubt, is aware the Sovereign management team have to contend with corporate ructions at a time when all their attention should be on operational matters.

Since an AGM in August last year when Sovereign shareholders vented their dissatisfaction about a performance bonus payment which shaved more than 20c/share off earnings, the company has been dogged by shareholder conflict. Subsequent efforts, via a management-backed empowerment scheme, to placate the disgruntled shareholders also had detractors. Last month, dissenting shareholders, including boutique investment houses Opportune Investments, 36One, Tantalum and Afrifocus, came close to forcing Sovereign to take the empowerment scheme to court for approval.

The dissenting shareholders, representing about 9m shares, also seem determined to exercise their appraisal rights.

This minority protection mechanism allows them to sell back their shares to Sovereign at fair value.

The latest twist in the saga is that Opportune Investments has resorted to a Promotion of Access to Information Act application to force Sovereign to release key documents, including the irrevocable undertakings provided by institutional shareholders, in support of Sovereign's proposed empowerment deal. They also want to see documents evidencing the extent of the contingency basis for corporate adviser One Capital's fee of R12.5m for structuring the BEE transaction.

But the key issue is securing Sovereign's reply to a hard-hitting open letter penned last September by shareholder Asief Mohamed of Aeon Asset Management.

It seems Opportune's combative CE, Chris Logan, is building a case for forcing Sovereign's executives to pay back the bonus money earned in the 2015 financial year. Logan was a central figure in last year's saga at Distribution & Warehousing Network, where two executives agreed to pay back bonuses that shareholders felt were not justified.

Some of the central points of Mohamed's letter are critical in assessing executive performance bonuses.

Mohamed argued that Sovereign directors had not exercised their fiduciary responsibility to act in the best interests of shareholders, because they had lowered the threshold to enable the executive management to earn bonuses and additional share option allocations for the 2015 financial year.

Basically, Sovereign's short-term incentive was changed from a performance gauge linked to return on assets and equity to one that was based on an earnings before interest and tax margin comparison.

But shareholders weren't informed of the change, as required by the JSE.

As Mohamed pointed out, if the performance measure had not changed there would not have been any short-term incentives payable.

He also chided his fellow fund managers for voting in favour of the company's non-binding executive remuneration policy.

Mohamed said it was distressing that institutional shareholders voted in favour of the resolution when, in most instances, they were aware of these issues beforehand. “Corporate SA has to lead by example, in this case institutional shareholders in general failed SA. Our view is that in general institutional shareholders are paying lip service to the PRI (principles for responsible investing) and the Crisa (code for responsible investing).”

Corporate philosophy aside, part of Logan’s strategy is to secure a put option via an appraisal rights mechanism attached to Sovereign’s empowerment deal. That probably applies to other dissenting minorities too, such as investment entities associated with Country Bird Holdings prime mover Kevin James.

In essence, the appraisal rights allow shareholders to opt out via a share buy-back arrangement. But there are two complications. First, Sovereign chairman Tom Pritchard was at pains to stress the fair value price of 850c/share, as reflected in the empowerment circular, might not necessarily be the price that is tagged to the appraisal rights arrangement. Second, Sovereign can call off its empowerment deal if more than 5% of shareholders opt to go the appraisal rights route.

At this point it appears as if roughly 12% of Sovereign’s shareholders would exercise their appraisal rights. This would cost Sovereign over R70m, an inconvenient cost at this tricky time in the poultry cycle.

Perhaps Sovereign would prefer to shed its dissenting shareholders sooner rather than later. Judging by utterances at the recent general meeting, it seems that the appraisal rights exercise could be contentious if the fair value range were to be lowered in view of the prevailing tough trading conditions in the poultry sector.

Of course, a lower fair value indicator would be a double-edged sword. It would represent a considerable discount to tangible NAV.

It would also reinforce arguments by certain minority shareholders that Sovereign remains a serial underperformer and its management don’t deserve performance bonus payments.

What’s more, if Sovereign’s board put a lower fair value on the business — say a range of 700c-750c/share — then it would be difficult to fend off a corporate raider making a hostile bid at the latest fair value price of 850c/share or even closer to the R10/share NAV.

Punters keen to nibble on poultry stock for a recovery might find the Sovereign situation quite compelling. The equation is simple: either management work tirelessly to maintain margins above the industry average or the share price continues to dribble down, much to the delight of predators.

The bigger consideration, though, is the invidious position of institutional shareholders backing Sovereign in its empowerment endeavours. If current trading informs a decision to lower the appraisal rights price from the 850c/share indicated in the empowerment circular, then institutions will in effect be backing an executive team that is undermining the value of the company.

It’s plausible then that one or two of Sovereign’s staunch backers may, in time, become less averse to larger rivals or agribusinesses stalking this hen-house.