Smithfield Foods Merger with Shuanghui International: Pig in the Hand, or Two in the Poke?

ISS Recommendation: Vote FOR the transaction

On May 29, 2013, the board of SFD announced an agreement to sell the entire company to Chinese meat processor Shuanghui International Holdings Ltd. for $34.00 in cash per share, a 30.9% premium over the unaffected price. The market responded enthusiastically, bidding up SFD shares more than 28% on the first day of trading post-announcement.

Little more than two weeks later, however, the company's second-largest beneficial holder, Starboard Starboard Value LP (5.7%), announced it believed the company would bring higher value if its divisions were sold separately. Starboard's announcement echoed the views of another large shareholder, Continental Grain Corp., which in March 2013 had requested that the firm split itself into three independent companies to unlock value. After the Shuanghui announcement, however, Continental Grain sold its entire stake.

Starboard, by contrast, retained an investment bank and launched a separate sales process to solicit bids for the various divisions, which it expected to ultimately roll up into a single, superior offer it would present to the board. In a Sept. 3 letter to shareholders, Starboard revealed it has received written indications of interest for each of Smithfield's assets for a price "substantially in excess of the $34 cash deal." The letter did not, however, quantify what it meant by "substantially in excess," nor did the fund announce completion of its process or present the board and shareholders with a committed alternative proposal.

Instead, Starboard announced that, while it prefers the Shuanghui offer to a stand-alone alternative, it intends to vote AGAINST the merger for now in order to compel the board to adjourn the meeting by several weeks – and give Starboard's process additional time to complete an alternative offer at a higher valuation.

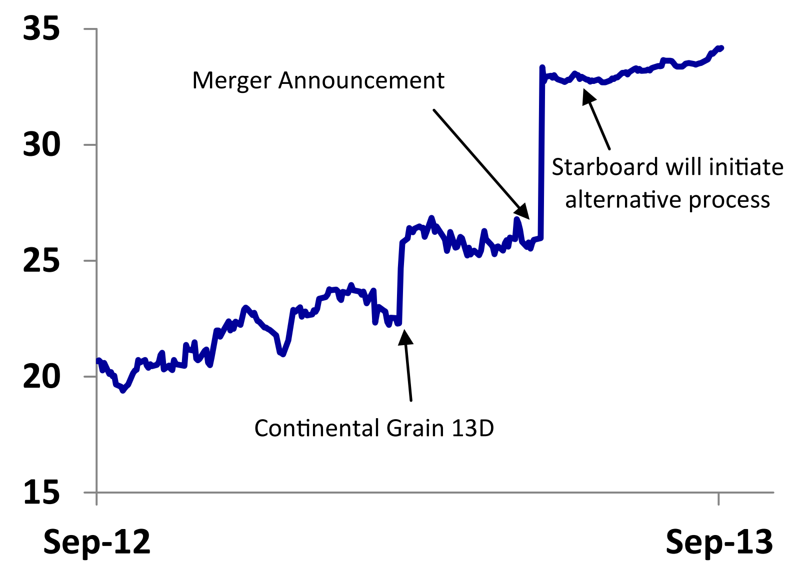
The $34.00 per share cash offer provides shareholders with a considerable and certain premium to the company's standalone trading price. The certainty of the deal's closure has also improved considerably over the last several months, as Shuanghui secured its committed financing and the merger re-

COMPANIES MENTIONED IN THIS NOTE:

- **Smithfield Foods, Inc.**
- **Shuanghui International Holdings, Ltd.**

CHART FOCUS

SFD — Share Price Performance



Sources: Bloomberg LP (share prices) media reports and regulatory filings (annotations)

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ceived regulatory approval under HSR and CFIUS. Given the board's eagerness to consummate the merger before year end, the receipt of the consideration in the near future appears increasingly certain.

The company's lack of an auction process is a concerning, as shareholders now lack some reassurance that the Shuanghui deal was truly the best deal available. The limited post-merger go-shop does little to alleviate these concerns, since the other bidders were placed at a relative disadvantage and were required to compete against a fully negotiated and agreed-upon public offer. Starboard's alternate sales process further heightened these concerns, since on the surface it appears unlikely that any investor would hire the investment bank and conduct such a process without a compelling belief that a superior offer was achievable by selling the operating segments individually.

It is never pretty to see how the sausage actually gets made – but in this case, shareholders do appear justified in believing the sales process the company put together was less than robust.

On the other hand – in the same way that even a blind hog finds an acorn sometimes – a weak sales process may sometimes, despite itself, root out the best available alternative.

The proof, at this point, appears to be in the lack of any competing offers for the company as a whole. Though the board's process lacked a robust market check, there are also probably relatively few potential buyers for Smithfield due to its size and the antitrust complications within its industry. The market reaction so far appears to corroborate the board's argument that further, materially higher bids are unlikely – as of Sept. 11, 2013, shares closed at $34.17, at best marginally higher than the offer, suggesting that investors do not believe a significantly higher offer will emerge from Starboard's alternative process.

Starboard raises a valid question unaffiliated shareholders should consider: if a shareholder-driven sales process holds out promise of delivering higher value by selling the company in parts, why not vote against the transaction on this first ballot, force a postponement, and give that alternative sales process more time? If Shuanghui cannot unilaterally rescind its $34 per share offer for another two months, shareholders effectively avail themselves of a free option by voting against the Shuanghui deal on this first ballot.

One compelling answer, in part, is that the shareholder vote itself can serve as a disciplining force on potential bidders, separating those who may only be dallying from those who see such significant strategic and economic opportunity in a competing bid that they are willing to pay current shareholders a significantly higher price for the assets. Though only two weeks remain to the shareholder vote – which sounds like a tight timeline to pull together a competing bid – fully three and a half months have passed since the transaction was announced.

Rather than wondering whether the two remaining weeks are enough, shareholders might consider whether bidders who need an extension, after four full months, are truly motivated bidders. The issue is not whether Starboard, as a significant shareholder, is actively seeking an alternative which maximizes value; the issue is whether voting against an agreed cash deal at a meaningful premium is a give the potential bidders – not Starboard – have actually earned the right to request.

Though shareholders should remain keenly attentive to any future announcements from Starboard about results and timing from its process, the information provided to date does not appear sufficiently compelling to warrant a vote against the bird in the hand, even for the sake of extending the time available to the Starboard process. Shareholders, moreover, can always change their vote: voting in support of the merger at this juncture does not eliminate shareholders' optionality should more compelling information emerge from Starboard's process.

As such, ISS recommends that clients vote FOR the merger with Shaunghui in light of the considerable premium offered by the deal and the certainty of value provided by the all-cash consideration.

Should additional disclosures about the Starboard process provide compelling reason to believe the Shuanghui offer does not in fact maximize shareholder value, however, ISS may revisit this recommendation.

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We will continue to monitor this situation and market trends, speak with interested parties and, where relevant, issue additional *M&A Edge* notes to provide further information and guidance for clients.

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