

Hostile Acquisition Offers – The Responsibilities of the Target Board A Case Study of the AirTran Offer for Midwest Airlines

Follow-Up Findings: The Certainty of Cash

By W. McGinnis Advisors, LLC
Report as of May 27, 2008

The original report can be found at www.wmcginnisadvisors.com/midwest-original.htm.

Summary

A year after the initial analysis, this follow-up report examines changes related to our example company since that time. The previous report noted that Midwest's Board might be rejecting the AirTran's offers due to risks associated with the stock component of its offer. The report noted three specific reasons to be concerned about shares offered in a hostile takeover. Given the passing of time, there is now the opportunity to examine the potential impact of share price movements. AirTran's shares have declined 71% since its last offer was made, which would have resulted in a 27% decline in the combined cash and stock offer value. This exemplifies the risks of accepting stock in a hostile takeover.

Events Subsequent to the Original May 11, 2007 Report

AirTran raised its offer for the shares of Midwest Air Group several times. The final offer on August 14, 2007, was valued by AirTran at \$16.25 per share in cash and stock. The offer was comprised of \$10.00 in cash and 0.6056 shares of AirTran per Midwest share. Based on the previous closing price of \$10.32 per share, the share component of the offer was worth \$6.25 per Midwest share. Thus, the offer was 62% cash and 38% stock.

TPG Capital, which had made an earlier bid, raised its offer to \$17.00 in cash on August 14, 2007. That offer was accepted by Midwest's Board on August 16, and the acquisition by TPG Capital was completed on February 1, 2008.

Issues Related to Shares Offered in the Original Report

The original report noted seven reasons that a target Board might reject a hostile takeover offer. Include among these were the following three that relate specifically to offers that include the buyer's shares:

1. Is it a cash offer?
2. What is the value of the offered shares?
3. Would our shareholders want to own the offered shares?

Each of these three reasons are discussed in detail in the original report.

The Dangers of Share Price Declines – Evidence

AirTran's closing share price the day before its final offer on August 14, 2007, was \$10.32. Two trading days earlier, the shares had closed at \$11.02. Today, approximately nine months later, the shares most recently closed at \$3.00 per share. Within the last week, the shares have traded as low as \$2.73.

The recent \$3.00 price represents a 70.9% decline from the \$10.32 price included in the final offer last August. As approximately 38.5% of the offer was comprised of AirTran shares, the total offer value is now 27.3% lower than it was at that time – \$11.82 vs. \$16.25. The shares would have to increase 244% from the current level for the former Midwest shareholders to breakeven.

The Impact On Total Deal Value

AirTran's final offer was comprised of approximately \$273.8 million of cash and shares worth approximately \$171.1 million. Today, the value of the same number of shares has declined to \$49.8 million for a net value loss of \$121.3 million.

Why The Certainty of Cash Can Be Attractive

In contrast to the potential losses outlined above, Midwest's Board accepted a \$17.00 per share cash offer from TPG Capital. The attractive part about a cash offer is that its value is known – \$17.00 is \$17.00. There's no risk of share price declines.

The accepted offer is currently 43.8% higher than the current value of AirTran's final offer. On the date the offer was made, the difference was only 4.6%. This clearly points out the risk to target shareholders when an acquirer's share price declines. Clearly, the comparison would have been much different had AirTran's price increased, but that's not what happened. It's highly unlikely that anyone could have predicted the decline that has taken place, but it was easy to understand that *any* decrease in price would serve to deflate the value received. Accepting an all-cash offer locks in the value received.

Selected Factors and Assumptions

There are several factors and assumptions inherent in the above analysis:

1. ***Shares not sold*** – The analysis assumes that if Midwest shareholders had received AirTran shares, they would not have sold them. While this would not likely be the case for all investors, it would be true for some. Due to potential tax consequences, inattentiveness, a belief in the potential success of the combined companies or any number of other factors, some unknowable number of shares would still be in the hands of former Midwest investors. Further, any significant sale of AirTran shares by former Midwest shareholders would have put downward pressure on AirTran's share price.
2. ***Cash remains at a steady value*** – No assumptions have been made regarding how Midwest's shareholders may have invested the cash they received in the sale. They may have invested it very successfully, very poorly or not at all. As it's not possible to know or estimate the returns that would have been earned to date, the conservative approach is to assume that the funds were simply held as cash and, thus, are worth the same amount today as when received. In the analysis, this

- approach was applied to both the cash received in the actual sale and the cash portion of the offer from AirTran.
3. ***AirTran has been caught in an industry-wide decline*** – Clearly rising fuel prices and other broad-based economic factors have negatively impacted the entire airline industry including AirTran. However, these risks are negated in all-cash offers.
 4. ***Midwest may have been impacted by the same industry-wide factors*** – While that may be true, it is irrelevant to this analysis. The \$17.00 of cash paid by TPG Capital was in no way tied to Midwest’s future performance. Any challenges that Midwest may be facing today are solely TPG’s problem and do not negatively affect Midwest’s former shareholders.
 5. ***AirTran shares may have performed better if the Midwest acquisition had been completed*** – While this is possible, it is also possible that the AirTran shares may have performed *more poorly* in a combination with Midwest. AirTran’s management clearly would have faced many challenges in combining the two organizations, as is true in any acquisition. It is not possible to estimate what the results may have been had AirTran been successful in acquiring Midwest.
 6. **Potential Tax Consequences** – A cash sale creates a taxable event for many shareholders. However, it is important to understand that companies don’t know what percentage of their shares are held in non-taxable accounts, the price at which shareholders purchased their shares, shareholders’ marginal tax rates, and other factors that impact potential tax consequences. It is certainly fair to say that non-taxable share-for-share exchanges are cleaner for shareholders from a tax standpoint, but this benefit comes at the risk of share price declines or under-performance.

Hostile Takeover Offers Can Be Especially Challenging for a Board

In a friendly acquisition, the target Board may have access to more information about the acquiring company and its plans for the combined companies. This more open information flow may allow the target Board to become more comfortable with risks inherent in accepting an acquirer’s stock.

On the contrary, the hostility that is often present in a hostile takeover attempt may prevent a target Board from developing the same level of comfort. While the acquiring company’s management is likely to be extolling the virtues of combining forces, it would be reasonable to assume that the target Board may be discounting such. This can make it difficult for those Board members to feel comfortable in recommending a stock or cash and stock transaction to its shareholders.

These Risks Apply Broadly to Hostile Takeover Offers

While our original report and this follow-up are both focused on AirTran as an example, the issues raised and potential consequences are in no way unique to AirTran. Any hostile acquisition offer that includes at least a portion of the acquirer’s shares would benefit from similar considerations. Microsoft’s recent hostile acquisition interest in

Yahoo is one of many current examples where the original report’s “seven reasons a Board might reject a hostile takeover offer” may apply.

Conclusion

The potential loss that would result from a decline in an acquirer’s share price is an important factor for Boards of Directors of target companies to consider. Future share prices can significantly impact the value shareholders receive in a hostile acquisition.

Disclosure: Neither W. McGinnis Advisors, LLC nor the preparer of this report, William W. McGinnis, CFA, have ever held any investments related to any of the companies mentioned. Likewise, neither W. McGinnis Advisors, LLC nor William W. McGinnis have or have had any business relationship with any of these companies. Nothing in this report should be construed to be an investment recommendation related to or and offer to buy or sell the securities of any company mentioned herein.

Source: W. McGinnis Advisors, LLC, Milwaukee, WI – www.wmcginnisadvisors.com

Contact: Media Inquiries, Bill McGinnis, 414-228-1888, bill@wmcginnisadvisors.com

About W. McGinnis Advisors, LLC

W. McGinnis Advisors, LLC specializes in providing expert witness testimony and opinions worldwide in investments and securities cases. The firm, headed by William W. McGinnis, CFA, assists plaintiffs or defendants in cases relating to mergers & acquisitions, stock and business valuations, investment suitability and investment research issues.

William McGinnis, a Chartered Financial Analyst, has worked in investment analysis, portfolio management, mergers & acquisitions and the provision of professional opinions on such matters for over 25 years.

More information about W. McGinnis Advisors, LLC and William W. McGinnis, CFA is available at www.wmcginnisadvisors.com. Bill McGinnis is a securities expert witness and consultant based in Milwaukee, WI.