



Activists Could Shake Up Tier Technologies

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The past few years have been difficult for the board of directors at **Tier Technologies** (TIER) . In 2004, the company had a dispute with its audit firm over its internal control procedures for financial reporting, and as a result, it switched to a new independent financial examiner. Less than a year later, Tier disclosed that it was restating the prior three years' financials.

Much has transpired at Tier since then. After being de-listed from **Nasdaq**, the stock plunged, and the board installed a "poison pill" shareholder rights plan to help ward off any unwanted takeover attempts. During the same period, the **SEC** launched a formal investigation into the accounting irregularities, and the company spent millions on legal advisers and independent investigators to determine the scope and implications of the questionable accounting methods. For the board of directors and for the new management team brought in to clean up the mess, these are very difficult times. I know, because eight years ago I was part of a turnaround management team brought into a business after the board had removed the previous CEO for financial shenanigans. We faced many of the same complexities Tier has, and it took us two years to stabilize the business, restructure the entire management team, recruit new directors and restate financials.

Managing a business through this sort of chaos is extremely difficult; every aspect of the business is vulnerable. Customers shift to competitors, shareholders sue for misrepresentation, banks call outstanding debt obligations and restructure loan covenants, suppliers question the long-term viability of the business, and almost every employee begins looking for a more stable place to work. Through all this, the board and management have to stay centered on developing new strategies for growth, recruiting high-performing managers, improving operating efficiencies and cultivating a shareholder base that believes in the rejuvenated business and what it can achieve.

As if all of this weren't enough to contend with, Tier's board is now faced with two activist investors who together own close to 20% of the outstanding stock. The activists demand board representation and insist that shareholders would realize more value if the company were sold today.

Last December, Discovery Equity Partners, a 9.9% shareholder, sent a letter to the company nominating two individuals to the eight-person board. In the letter, Discovery argued that the company's unusually large cash balance of \$90 million, or about \$4.50 per share, is an inefficient use of capital and reflective of the board's poor judgment.

Discovery claims that, considering that the company has a market capitalization of just above \$100 million, Wall Street has ascribed very little value to the fact that Tier's main operating business generates over \$11 million in EBITDA before corporate overhead expenses are allocated. Discovery says that for that reason, its board nominees, if elected, "intend to help Tier expeditiously reduce excessive overhead, determine the appropriate amount of capital to return to shareholders, eliminate unnecessary corporate defenses, and proactively evaluate all strategic alternatives to unlock value."

Last week, Parthenon Investors II, another activist investor pressing for Tier to be sold, announced that it will attempt to replace two additional directors by appearing at the annual

meeting in person and nominating their candidates for election from the floor. Since Parthenon was given one seat on the board in March 2007, a success this year would increase its representation to three members.

In my circumstance, after cleaning up the beleaguered enterprise, we too faced a hostile battle for control from two activist investors who believed the value of the business was worth more broken up than as a whole. Ultimately, we were no match for the seasoned insurgents who had done this numerous times before. We lost the battle, the company was quickly put up for sale, and I left to begin advising boards of directors on how to proactively manage dissident shareholders.

Winning this proxy battle will not be any easier for Tier. The most important analysis of any proxy campaign is the shareholder vote projection. Understanding who shareholders may vote for will determine whether or not it's worth fighting. In Tier's case, it may be difficult to get a clear read on this.

According to Tier's bylaws, shareholders have cumulative voting rights in director elections. This means that shareholders have the right to pool their votes to elect one or more directors rather than apply their votes to the election of all directors.

For example, Tier has eight directors up for election this year. In statutory voting, a shareholder with 100 shares casts 100 votes for each opening ($100 \times 8 = 800$ votes). Under the cumulative voting method, however, the shareholder may choose to vote all 800 shares for one candidate, 400 votes each to two candidates, or otherwise divide the votes however preferred. As a result, it is quite possible that Discovery can obtain two board seats and Parthenon can obtain two additional board seats by directing their votes to the election of their respective candidates. If successful, the dissidents would control five of the eight board seats.

The challenge for shareholders is to decide who is best qualified to generate the greatest value for them. Discovery says plenty of buyers are ready and waiting to pay a premium for the business and that it intends to examine each of those options as soon as possible. Management, on the other hand, says it examined these very strategic alternatives a while ago and determined that shareholders will be better off realizing the longer-term benefits from what is now a substantially complete restructuring.

In any event, stockholders of record as of Jan. 16 will get their chance to weigh in at the shareholder meeting scheduled for March 11, 2009.

Elsewhere, other proxy fights are heating up. Activist hedge-fund investors were very busy at the end of 2008 despite lackluster returns and across-the-board redemptions within the industry.

In early December, Sandell Asset Management sent a letter to **Southern Union** (SUG) announcing its intention to run a proxy contest in order to obtain four seats on the 10-person board. Like the dissident shareholders at Tier, Sandell believes the best course of action for Southern Union shareholders is an immediate sale of the company.

Currently, Joseph Stilwell is attempting to gain board representation at **Kingsway Financial Services** (KFS) in an attempt to influence the board to sell its non-core businesses and use the excess capital to retire debt.

Hedge fund Southeastern Asset Management was recently offered board representation at **Sun Microsystems** (JAVA) after announcing its desire to work with management to improve value. Elsewhere, Southeastern changed its filing status with the **SEC** from passive to active for its investment in **Texas Industries** (TXI), where another activist investor, Shamrock Capital, has been rapidly increasing its ownership.

Looking forward, activist demands for improving share performance will likely increase in 2009. One company worth keeping an eye on is **Dr Pepper Snapple Group** (DPS) . Nelson Peltz, one of the more recognizable names in activist investing, recently disclosed a 7% ownership interest in DPS and announced his belief that the company is undervalued because Wall Street views the business as a bottling company and not a branded beverage company that owns a number of great brands, including 7Up, A&W, Canada Dry, Dr Pepper, Nantucket Nectars, Snapple and Yoo-hoo.

Considering Peltz's recent fight record (two wins, with **HJ Heinz** (HNZ) and **Wendy's** (WEN) , and no losses), it's highly probable we'll see something more develop here very soon.

At the time of publication, Park had no positions in stocks mentioned.

Please note that due to factors including low market capitalization and/or insufficient public float, we consider Tier Technologies to be a small-cap stock. You should be aware that such stocks are subject to more risk than stocks of larger companies, including greater volatility, lower liquidity and less publicly available information, and that postings such as this one can have an effect on their stock prices.

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Park is often quoted in leading business publications, including The Wall Street Journal, Business Week, CFO Magazine, The Deal, CNN Money, The New York Times, The Nikkei and Newsweek Japan. He speaks at professional conferences and is the chairman of the Hedge Fund Activism and Shareholder Value Summit, the largest annual gathering of activist hedge funds in the world. Hedge Fund Solutions administers [The Official Activist Investing Blog](#) and also distributes a free in-depth weekly report analyzing recent activist investments.