IFB224: What Happens to Your Shares in the Event of Big Changes, CEO Leaves, Acquisitions, or Other News?

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Dave

0:00

All right, folks, welcome to Investing for Beginners podcast. Tonight we have episode 224. And we're going to answer some great listener questions we got recently. So without any further ado, I will go ahead and read our first question. And then Andrew and I will do our usual give and take. All right, here we go. Hey, guys, fairly new listener here.

I have a question to ask for the podcast. What happens to your stock shares? When a company goes through a major change? I.e., the CEO retires or gets fired? The company is acquired by another company, or the company files for bankruptcy. How do you react to situations like this? Thanks for another great info. Dave in Denver, Colorado. All right, Andrew, what are your thoughts? Is Dave in Denver? That's a great question here.

Andrew

0:44

I like it; the answer for each of those are going to be different for each scenario. So I was looking at a company the other day who are going through CEO changes. So maybe I can; I'll tackle that one first. So what happens to your stock shares when the CEO retires or gets fired? Nothing changes with the shares themselves. So the business goes along, as usual. And the board of directors will do their best to try to figure out who the next CEO is going to be. We had an example of that recently with Starbucks, where their CEO retired; he had told the company well in advance. And so he retired. And so the founder actuAlly came in Howard Schultz; he's kind of a legend. And in the business world a little bit, he's in there as interim CEO as they try to recruit for a new CEO.

So what happened with the stock price is actuAlly went up 5% when they found out about Howard Schultz becoming interim CEO because people love Howard Schultz; as I say, he's a legend. There was another company I was looking at in the banking industry, and they had a CEO kind of mysteriously go under medical leave, and then some other executives left, too. And so, the stock has been hammered because there's so much uncertainty around what's going to happen with the leadership.

So the stock can move anyway when you have a CEO change and the transition. What happens to your actual shares, though, is nothing; you still own part of that company, and business goes on, as usual; what happens to your shares what those a couple of other scenarios actuAlly can be different. But for a CEO transition, nothing happens to your shares, and the market could go up? Or could it go down?

Dave

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Is there anything that you would do if a founder-led company, let's say that when Steve Jobs left Apple, would you would that cause you to rethink your decision to be invested in that company, A

Andrew

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I would say probably not in the way of like, you kind of have to give new CEOs the benefit of the doubt. And especiAlly if a business has been doing well, this is all my opinion, obviously. But if the business has been doing well, that culture should still be in place. And so a CEO might, might come in and might ruin things, but you kind of hope that they don't rock the boat and just keep this gravy train rolling, you know, but you do want to kind of take a look at if the CEO is doing something that doesn't seem very prudent like I actuAlly dealt with this a couple of months ago, it wasn't a new CEO, but it was CEO of a company and had like a spotty track record.

But I kind of like the price of the stock was that. And then they go, and they make this acquisition using like eight years of cash flows. Such a huge, huge acquisition. And that's like a reAlly risky thing to do with investors' money. So I got out of that stock, but kind of the way I look at it, which almost seems taboo these days, I feel like you're innocent until proven guilty. And, you know, that's kind of how you have to operate when you're if you reAlly want to invest for the long term.

Because you're gonna have CEO changes all the time. I mean, not like every day, but over a five, seven-year period, that's probably around the average tenure of a CEO 567 years. So you're gonna have to deal with some CEO changes as you invest for the long term. And if you're just jumping the gun because you're nervous over somebody ruining the stew, then, you know, it's gonna be tough to be long-term investments. D

Dave

4:24

Yeah, I agree with that. So something that kind of pops to mind is, what was that Peter Lynch quote about a company and I'm a monkey or something.

A

Andrew

4:36

About like, where was it? Buffett? He said You want to invest in a business that's so great. Is that the quote? Yeah, well, investing in the business is so good that an idiot could run it because they'll say an idiot. Well,

D

Dave

4:49

right. So I think that maybe kind of goes a little bit to what Andrew was talking about is reAlly giving the replacement or the new person a bit of time to figure it out. If that person is going to be the one to run the bus or not, I would agree with everything that Andrew was saying. I think the bigger issue is if you see that the company is making computers and all of sudden it decides it wants to be in the pizza industry, then okay, well, maybe it's time to go jump ship. But if they're continuing the gravy train, then you know, chances are that you may not know it. And sometimes you can determine it; the CEO that's replacing the one going out could have been groomed to take that person's place.

And in the case of the First Republic, which was the company Andrew was referring to earlier, they lost their CEO under kind of a little bit mysterious circumstances. And then the woman that they are grooming to take his place because he was planning to retire anyway. Then she up and left not too long after this person after the current CEO, stepped aside. So it was just all kind of reAlly kind of strange timing. And then I think they lost the CFO at the same time. So it was like the three top positions all of a sudden, and we're just, so you know, that can be kind of a scary situation because now you got the Titanic barreling down the road without anybody driving the bus.

So, yeah, those are things you have to think about. Okay, so let's talk about the second part of this question here. So what happens to the stock shares of the company are acquired by another company.

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Andrew

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So what happens to your shares, if your company gets acquired, it's reAlly going to depend on how it was acquired? Was the acquire paying in cash? Are they paying with their own shares? And so both of those can happen pretty often, if, let's say, Berkshire is a good example, they just bought Ali Ghani, the insurance company, and they're paying in cash. So if you're a shareholder of Allegany, and Buffett is saying, Hey, I'm gonna pay you this amount per share for your shares. Cool. If it's 100 bucks a share, I'm getting $100 For my shares from Berkshire. And it goes through the whole legal process.

And there's a time period for that. So we mentioned that when we talked about the arbitrage with Microsoft and Activision, there's a long time for that to process before it all goes through; you know, you can get most of the amount of what the acquisitions are going for by selling your shares, because the shares will pop up very close to what the deal, what the final deal is that, but that's not final, and that does take time. And there can be drama around that. But that's the general gist.

The second option is if a company pays with their own shares if they are acquiring the shares you own by using their own shares. So, Dave, you mentioned square acquired after pay using shares. Can you break down like if you're a shareholder of Afterpay, what happens to your shares after the acquisition closes, D

Dave

7:50

After the acquisition closes, when now block bought after pay, I think they just closed on the transaction just recently, you get a percentage of block shares for your Afterpay shares. So now you become an owner of Block. And it depends on what rate they work out for the exchange. So I don't have the numbers here in front of me, but a lot of times, it would be more than your own. So let's say, for example, you own, to make it easy, ten shares of afterpay; you might acquire 11 or 12 shares of Block.

So now you own those shares of Block, and you get to decide whether you want to keep those shares or sell them after the transaction is done. So now, instead of owning after pay, now you own Block. And so that's kind of how it works. ReAlly, when they announce the deal, they will list how the acquisition is going to be financed. So it will either be in cash, it could be cash and shares, or it could be shared, and they will tell you right up front how many shares of each and how that's going to all transfer, but that's how they'll do that. I know that when Amazon bought the grocer Whole Foods, that's kind of what they did.

And Pfizer, when they bought WorldPay, that's what they did as well; they offered shares as well. So those are ways that company will use their equity, I guess, to acquire the company, so I guess the trick is deciding whether you want to be an owner of Amazon or Pfizer or Block or whether you want to sell out at

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Andrew

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that point, and that's gonna be the answer to that, is gonna be different in every situation; the way that the number of shares gets determined it's reAlly based on like to use Amazon as an example. They said, hey, we're gonna pay you to know, however, many billions of dollars to buy whole foods of Amazon share price was 2000 or something, and they're issuing that many shares of Amazon they'd like in a dilute the number of shares to pay for, let's say $2 billion To buy whole foods, and then however many of shares that equal then gets distributed evenly to all the shareholders of Whole Foods or whoever the company is.

And so that's why those numbers, we can't just say all it's going to be like this for every company, because it depends on how much the company's paying for how much they're paying in dollars, and then how many shares they're issuing to get to that, which depends on Amazon stock price, and then how many shares wholefoods was split into, and then, you know, Amazon shares will get split into the whole foods, shareholders and they'll each get their allocated amount per share of that they own

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Dave

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exactly, and each deal is going to be different. And the general running rule, if you will, is the company that's being acquired? Will the premium is it can rain, but kind of the average is around 30%. But it can go much higher than that, depending on how much bidding there may be or how badly the acquiring company wants the acquiree. And I know that I'm in this situation right now with a company that I own, first horizon, which is a small regional bank that I own, based out of kind of the southeast, was recently acquired by Toronto Dominion Bank out of Canada. And so the deal isn't final yet.

And the stock price, I didn't even know the deal was happening. To be honest with you, I just happened to look at my brokerage account, and all of a sudden, the price was up almost 30%. And one day, I'm like, what happened? So I had to go on the news and find out, oh, they accepted a bid to be acquired by TD Bank. So I haven't decided whether I want to keep the shares or not, or even frankly, looked into the deal yet, because it just happened about a week ago or so.

So I got some time to figure out what I wanted to do. But yeah, so it does happen. And it is something to be aware of. And you have to decide what it is you want to do. If you want to own that company, whether you want to be a shareholder of Amazon or not, or Block or TD Bank. And that's what I have to decide if it's going to be a share deal, then I have to decide if I want to own TD Bank because I don't know if I do or not. And so, I need to do some research and decide if that's something I want to own. If I do, then I'll just stay where I am. If I don't, then I will sell those shares and use that capital to invest in something else.

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Andrew

12:18

Yeah, that's very well said; good explanation. So I guess the last option, what happens if your company files for bankruptcy, what happens to your shares, this one's not as fun to talk about?

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Dave

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No. Again, it can depend on exactly the situation. But as a shareholder of the company, chances are, you're going to lose everything. So whatever was there, it's going to go to zero. This is the worst-case scenario in investing in the stock market. As bad as some of the stock drops have been recently in the market over the last few months. The worst, this is the worst; going to zero is the absolute worst.

And as a shareholder, we have the least rights to any money that could be received. If the company is liquidated and they sell off the remaining assets. Most of that is going to go to bondholders and preferred stockholders, and we are last in line. So as a stock shareholder, this will be, we will be the last position, and most of the time, we'll get nothing.

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Andrew

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That's like if you look at entrepreneurs, they take all of the risks, whether that's sweat equity risk or whether that's putting money into a business. And then so, they get to reap all the profits. It's the same thing in the stock market; the equity holders, which are stockholders, people owning the shares, they're taking that risk. And so if the company flops, you're exactly right; you're gonna get wiped out. And then the people who are the lenders to the business, like bondholders, get paid first, and they usuAlly don't get everything they were owed, but they get like a settlement in court. And they're able to pick up at least some of the money they were owed from that business that goes bankrupt.

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Dave

13:59

Yeah, exactly. It's not the fun part of the investing world for sure. But it is the ultimate risk. And something you have to think about when you are investing is, you know, what is the likelihood of this company going bankrupt. And using tools like Andrews VTi is a great way to help avoid bankruptcies. There's also, looking at the bond ratings of the company will also tell you how likely it is to go bankrupt. It's not a for sure thing; nothing's a for sure thing in the stock market. But those are some, I guess, quick, easy tools that you can use to help you determine how risky business and that's reAlly what we're talking about.

When we're talking about the risk, we're reAlly talking about going to zero. It's not necessarily about losing having a stock dropped 50% in a couple of months because that's just part of volatility, but actuAlly losing all your money that you're, you know, having no recourse to recoup your money at all. That's the ultimate bummer.

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Andrew

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Yeah, that's where the numbers come in. And that goes to a lot of what we say about Knowing what you own, and you know, some of that is knowing the numbers, but it's also knowing like, how does this business make money? And what are the other competitive forces that are gonna prevent it from making money and you try to avoid the businesses that are not in good competitive situations. And that can help a lot with the whole bankruptcy risk in addition to everything else.

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Dave

15:21

Yep, yep, exactly. Alright, let's move on to something a little more cheery, shall we? Alright, so, Hi, Andrew. I am from the UK and reAlly enjoy both of your insights and approaches to the market. In a time where there is so much noise and misleading information. We're getting started on my investing journey. I am 28. Now, 29 have recently bought a house and now want to start investing for my future with my wife and potential future children. I am drawn to strong dividend-paying companies.

My question relates to a purchase of a stock that I believe you and Dave both made, which goes slightly against the grain. I think you made reference to this in an earlier episode. Why did you both buy shares in Berkshire Hathaway when it doesn't pay a dividend? I'm intrigued to know what caused you to break this rule and what the end goal is. Kind regards Ashley weeks,

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Andrew

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So I'm not gonna speak for Dave Ahern because I'm not they've ever heard. And I'm Andrew Sather. And I did buy one share of Berkshire Hathaway. And so that was so I could go to the annual meeting that he does in Omaha. So I was fortunate to be able to go; I think it was in 2018. And so all you had to do was just prove that you had at least one share of Berkshire. So I had my one share, and that's been the extent of that. But other than that, yeah, I've reAlly stuck to my whole dividend-paying framework.

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Dave

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Well, alright, so I am Dave Ahern; I will speak for myself and no one else. So I have not represented Andrew, and this is a conversation. All right. So I have a strong conviction about trying to buy companies that pay a dividend. However, I will break out of the box if I find a company that I think is worthwhile investing in that I think is still going to give me great returns over a long period of time. And I think that Warren Buffett has proven unequivocAlly that he is probably the greatest or one of the greatest capital allocators ever. And so, having given him my money, who do as he will with it, to grow, the value of Berkshire, I feel like is worth its weight in gold. And he buys companies that pay dividends; I think to be pretty, all of the companies he buys pay dividends, I believe, and don't hold big ones.

Yeah. Yeah, yeah, the big portion of and if you look at the cash flow generation of the companies that he owns within Berkshire, it's kind of staggering. And from the insurance businesses to the, to the train business, to the real estate, to the energy businesses that have retail, just across the board is just, you know, one success after another. He's got a few clunkers in there; it's not perfect. He's not, you know, superhuman, but I think the point is, is that this company generates a ton of cash flow, and they also are growing, you know, like a weed. And they also buy back, you know, a ton of shares. And even though he isn't actuAlly paying a dividend, there are not a lot of people that I would rather have him manage the money than me, just to be blunt.

And by me giving, if he paid me a dividend, I would just reinvest it back in Berkshire anyway. So for me, it just makes more sense to let him allocate his returns at a higher return than a dividend is going to pay me. And so, in the long run, I feel like I would make a better investment. Now, having said all that, and kind of going back to the earlier question about what happens when there's a change, unfortunately, Charlie and Warren are up in yours. And at some point, they will not be running the company anymore, whether it's they retire, or whether they, you know, go to the other plane. And so, at some point, I'm going to have to decide whether I think that the people that are running Berkshire after those two are not involved are still running it at that same level; that'll be a decision we'll have to make at that point. But at this point, for me, it's an investment that I've made, and I think it is a great investment. And not only is the actual investment, I think, a great investment. But the companies that he has bought and built around the conglomerate is Berkshire are fantastic businesses that I would want to own individuAlly.

So whether it was the energy business, Berkshire energy or whether it was BNS BNSF the train or whether it was all the insurance agencies, I mean, Geico alone, be worth, you know, hundreds of billions of dollars and so these are ridiculously good businesses, and our cash for generating businesses that I want to own for a long period of time, so for me, it's kind of a no brainer. Plus, it allows me to have admission to the Berkshire Hathaway meeting in the future if I want to go. And so that's yeah, I mean, it's, it's just for me, it's just a win-win. It's, it's definitely an investment that I do not lose sleep at night thinking about. Yeah, and you shouldn't know. I actuAlly wish I owned more.

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Andrew

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That's the bane of being an investor actuAlly did have a second part to the question. I think it was interesting. And this could actuAlly get us into a whole different can of worms as well. How the question regarding something that a UK broker free trade has just announced, they are forcing all customers to agree for them, to be able to loan our shares out as securities on which the company makes money on to support their long term goals of maintaining commission-free share trading. What are your thoughts on brokers doing security training? Should I jump ship?

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Dave

20:59

So this is an interesting, very interesting discussion, and is a very interesting question. So I guess I don't know; I'll preface all this by saying I'm not familiar with free trade. So I don't know what their statuses here in the United States, depending on what the brokerage was if it was something like Schwab, or Fidelity or Ally, trade, big companies that have a lot of liquidity, a lot of capital, a long history of being stable, secure companies, I don't think I would have a lot of qualms about something like this.

However, on the flip side of that, if it was a young, unestablished, not a long track record, not a great record, in general, I'm looking at you, Robin Hood, if somebody like that came to me like this, I'm out No way. If I let those people do this, they can't manage their own business; I would never let them manage my investments. So I guess having said that, Andrew, what are your thoughts?

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Andrew

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So I had Ally offer this to me. So basically, I said, Sure, why not? And it was just like a pop-up on the screen. And they say, Can we loan out your shares? I said, Sure. Why not? Because I was just curious what would happen. So what they do is; apparently, my shares are loaned out to them; I still own the shares. And then I get a few pennies. I think it's like six cents seven cents eight cents a month from Ally as interest for me having loaned those shares. And so I don't know exactly why they're loaning the shares for me; I'm not like in the brokerage, you know, work in brokerages, my guess is that it probably has to do with like short selling, or other traders are like Trading on margin.

And they're probably using those shares for those people. With those very clear with Ally that I still own the shares, they're just, I guess, by loaning them out, I get the sense that they're locked up, so I can't sell them while they're locked up. I'm a long-term investor. So I don't reAlly mind too much anyway; there's always the risk of a broker being irresponsible, and that potentiAlly having an effect on your own investments. And I think that's something we probably haven't touched on much. In the United States, you are covered; there is protection called si PC on it.

Yep. SIPC, so you're insured for up to $500,000. In case Ally or Schwab goes bankrupt. The SI PC will make sure you get the same number of shares that you had when it comes to a UK broker. I don't know if they have. I know they have regulators and everything; I don't know if they have exact protection on the amount of money that you have with the broker. And so that's what kind of makes me look a little suspiciously in how are they using those shares? And, you know, are they doing anything that's outside of the box of the regular brokerage industry that could put that company at risk. And then, if that brokerage goes under, you could potentially lose your shares. So like, the United States is an example of bringing it back. With Ally, if I had like a Million Dollar Portfolio with Ally and they were to go bankrupt, I'd be insured up to that $500,000. But the rest of it, go poof. Like, there's nothing you can do in that situation, I guess. Fortunately, throughout history, there's been a couple of times where companies have gotten to the edge with that. Merrill Lynch was an example during 2008 and 2009. These brokerages got bought out, and so their customers are basicAlly saved in that like they didn't have to deal with their shares being lost, but that is a risk that is present with brokers.

So like, if you have a couple of million dollars, it probably makes sense to put, you know, 500,000 here 500,000. There, you can have multiple different brokerage accounts. And you know, when Dave talks about the difference between reputable brokers and kind of new up and coming upstarts with, not much have a reputation for being around, you do have to be very, very careful because these brokers, they can all make their websites look the same. And if you don't pay attention enough, you could potentially find yourself in a broker; that's a risk to have your money in the first place outside of the risks that you take buying stocks. So if you stick to the burgers, or we like to recommend allies, well, I like Schwab, I like fidelity.

And I do have an Ally account. Those are all great brokers. I also like Merrill; I think they're a great broker. But I would try to stick with them. I can't speak for international brokers, but it's probably worth reading the fine print to see what they're doing and how you're protected. And with those brokers,D

Dave

25:45

Yeah, I would agree with that. I think reaching out to free trade and talking to them would probably be a pretty good choice. Just call them up and ask them what is involved in this, you know, swapping of shares or, you know, agreeing to loan their shares to them? A, what do you get out of it? Besides just the ability to trade for free? Is there some other benefit that you could receive or going to receive for allowing them to use your shares, and then ask them what the risks are, how are you protected on the downside for this is there some sort of insurance that if the, if something goes wrong with a company that you will be able to meet BB hold by all this; unfortunately, it can happen, that brokerages will go out of business. And it does happen occasionally; it's rare; it's probably more likely that other companies will swoop in and take over somebody like free trade.

And in that case, you don't necessarily you won't lose your shares. But you may lose some of the value because here in the United States, that's kind of the way it works is they won't necessarily recover your value, they won't recover your value, but they'll allow you to retain your shares. So if you own ten shares of Google, you'll still own those ten shares, but you may not get the full price that you pay, depending on what I was trading for at that time. So there's that kind of situation. But I agree with everything Andrew was saying. And I think it really would pay to do a little bit of due diligence. And if you are going to use any sort of brokerage account out there, whether it's here, whether it's in Canada, whether it's in Australia or England, or anywhere else, make sure you do a little bit of due diligence on that company, to make sure that they have the liquidity, they have a good reputation, and that they're going to treat you well, because you're giving them your hard-earned money, they need to work for you. And it's not the other way around. And so make sure that they're taking care of you.

And they're giving us, you know, some safety. I mean, emphasis is on the safety; this part of the emphasis is making sure that where you're putting your money to park it, for whatever period of time however you're parking it, it needs to be in a safe place, whether it's in a brokerage account, or whether it's in a bank account, they're both kinds of the same, it needs to be a safe place. So I would listen to what Andrew was saying; those recommendations are good choices.

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Andrew

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You'd be surprised; how insightful is this idea to just call them? That's a great idea. And if you can't reach them now, then what are you going to do when you actually have money with them and you can't reach them? That would be a problem. The last thing I would just say is kind of try to pay attention to where they're headquartered? Because I know there are a lot of websites. I mean, we've answered a question like this on the show previously, but just websites, it's kind of give you like a bad vibe. And I'm not saying this at all about the broker we're talking about today. But I'm just saying, in general, when you're researching brokers, look at where they are headquartered and look at what they say about regulation. And if there's any sort of protection, s. SIPC, if you're in the United States, just be careful of that.

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Dave

28:51

Yeah, I agree. That's all great advice. All right. So with that, we will go ahead and wrap up our conversation for today. I wanted to thank everybody for taking the time to send us those great questions; please keep a common. It's a lot of fun for us to do this. And hopefully, you guys get some good information. And a little entertainment along the way, as Andrew and I sometimes don't always agree. So although he did today, so without any further ado, go ahead and sign us off. You guys go out there and invest with a margin of safety, emphasis on safety. Have a great week, and we'll talk to you next week.