

## Shareholder Activism: Advice From the Trenches

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Agenda Week

The global spread of investor activism is top of mind for activists and experts who work with boards to counter them, based on panels and discussions with attendees at SkyTop Strategies' annual shareholder activism conference in New York late last month. Experts are also pondering how uncertainty in the U.S. and abroad may open the door for activists to target more vulnerable companies.

Agenda heard from consultants, investors, lawyers and other experts on both the corporate and activist side who shared their best insights into handling an activist approach.

"Shareholder activism preparedness has never been more important for boards and management teams," said Nick Lamplough, partner at strategic communications firm Joele Frank, on a panel.

"Activists are becoming increasingly sophisticated in approach, and companies should serve as their own activist by evaluating vulnerabilities and opportunities on an ongoing basis."

### More Activism in 2019?

According to new data from Lazard, a record 226 companies globally with at least \$500 million in market cap were targeted last year, up from 188 in 2017. And the fourth quarter was the most active on record both by campaign volume and capital deployed, according to Lazard. Plus, 161 board seats were won in 2018, up 56% from 2017.

For 2019, economists are predicting that the U.S. could see an economic downturn, which may leave companies more vulnerable to activism, sources say. Charlie Koons, managing director of activism and contested situations at Morrow Sodali, told Agenda at the sidelines of the conference that the volatility of the markets could give activists an opportunity to buy into a company at a lower price, particularly if the company has issues and needs a change. However, he notes, some activists are "quite beaten down" in terms of the returns they have seen.

"There was a lot of volatility in the fourth quarter, which has continued into 2019," said Taylor Ingraham, managing director at ASC Advisors, a strategic communications firm for investment managers, on a panel. "We will see how that impacts activism. Historically, volatility can lead to opportunities as issues at specific companies are exposed and stock prices are more impacted at some companies than others."

Boards can prepare for a potential activism influx by developing their business plan for a downturn, according to Stephen Brown, senior advisor at the board leadership center at KPMG. Going after undervalued companies during economic weakness is at the "heart of what [activists] do," Brown says.

Meanwhile companies based outside the U.S., as well as U.S. companies with global operations, should be aware of a burgeoning trend among activists, sources say.

"U.S.-based investors are becoming increasingly global in their shareholdings," Ingraham said. "At the same time, we are seeing companies and their stakeholders becoming more receptive to activists and engagement overseas. There is an effort globally to embrace activism as a means of change."

Indeed, U.S.-based funds engaged in high-profile campaigns against foreign companies in 2018 including at Barclays, Hyundai, Telecom Italia and Thyssenkrupp. Experts are expecting more this year.

Activists will continue to get smarter about crafting arguments based on location and vulnerability, said Jonathan Doorley, a partner in Brunswick's New York office focused on M&A and activism defense, on a panel.

"What works for activists in the U.S. is not necessarily going to work in all jurisdictions around the world," Doorley said. "Each local market has a series of written and unwritten rules, so the successful activists are the ones who are able to adjust their strategies accordingly."

With Brexit putting pressure on the British pound, several large British companies are trading at significant discounts to foreign peers, Doorley said. This could make British companies vulnerable to the approaches of activists and "unsolicited acquirers from overseas, both of whom may find a warm reception from frustrated shareholders," Doorley said.

### Communication Counts

Most experts agree that it's key for boards to have a strong relationship with their investors before being approached by an activist. Indeed, Brown said there are cases where activists have been communicating with other investors at the companies they target earlier than companies themselves have.

"Activists understand that they can't win a campaign if they don't have 51% of votes on their side, and those [votes] come from institutional investors," Brown said.

Engaging on environmental, social and governance issues to show the company's commitment to long-term value can give companies a leg up in a contest, Brown said. Meanwhile, Lamplough said a good investor relations program is "essential."

"It's the eyes, ears and engine for organizing where companies should spend time and how they should communicate," Lamplough said. "The goal should be that when an activist comes calling, a company's other shareholders are evaluating the activist's ideas in the context of a clear understanding of where management is taking the company."

Meanwhile, Brown noted that large-cap companies frequently employ tabletop exercises to prepare for an activist approach and encouraged smaller companies to do so as well.

"We have moved on from the phase of denial to the phase of preparation," said Alfredo Porretti, executive director of the shareholder activism and corporate defense practice at Morgan Stanley, on a panel. "Increasingly, we do exercises with companies that feel they might be at risk or are just proactive in dealing with corporate governance matters. They view this as a good exercise — play your own activist before one comes to the door."

Plus, executives, IR teams, legal and the board need to be on the same page in terms of strategic direction and response, Koons said. "There needs to be a good working relationship with the company

and its advisors so everyone is not talking over one another and should work well together as an orchestra,” Koons said.

All advisors at the conference recommended that boards engage with activists rather than ignore them if they are approached.

“You can sometimes tease out the goals of the activist based on the nature of [prior] communication but should still be responsive if an activist asks to meet with management,” Porretti said. “As large shareholders of the company, you owe them the courtesy of hearing them out.”

Brown said it’s also important during a contest that boards not take the issues brought up by activists personally. This is certainly difficult to do, as an individual director’s seat is often at risk during a contest, he added.

“Those that fare better don’t take it personally and remember that this is a business, and that helps them think clearer,” Brown said. “Unfortunately, some activists use personal attacks as a tactic to get boards to make suboptimal decisions in a campaign.”

After the contest, if an activist is named to the board, the dynamics will change, but Brown said it’s important for the incumbent directors to work with the new member.

“That has a lot to do with who the person is,” Brown said. “Some of the good ones understand board dynamics and personalities, while others don’t, but they are afforded the same rights the other directors have and [should] have access to the same information. Directors who have had activists on the board will say they learned a lot from the activists as they come in with a team of analysts.”

Ultimately, Koons said, “the job for [boards] has changed, and it’s important to be collegial and work well with one another, but also be prepared for some portion of them to engage with the investor community and articulate the board’s vision of long-term sustainable growth and oversee management’s execution of that.”