SKYTOP STRATEGIES

SHAPING THE FUTURE OF SHAREHOLDER ACTIVISM: AN INVESTIGATION OF 2018 ACTIVIST TRENDS

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Originally published on Forbes.com

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Christopher P. Skroupa: What have been the major trends in shareholder activism so far in 2018?

Aneliya S. Crawford: There have been record levels of shareholder activism in the first half of 2018 by most any metric: board seats gained, capital deployed, and the number of campaigns mounted. Activism continues to grow in both its impact on the markets and its role in pushing corporate governance forward. And while a few very active heavyweights such as Elliott Management, Icahn Partners, and Starboard Value account for a large portion of this equation, a bevy of new investors have also grabbed headlines with their first-ever activism campaigns this year. Each year, a wider variety of investors employ activist techniques, and that's a trend that should continue as investors fold environmental, social, and corporate governance issues into their investment theses and analyses.

Even first-time activists have, for the most part, launched major campaigns. Among the 20+ first-time activists have been hedge funds like Blackwells who guided Supervalu to sell itself; SRS Investment Management who gained board seats at Avis Budget Group; and Roaring Blue Lion who, ultimately, used a withhold campaign to bring attention to HomeStreet's struggling performance. SailingStone Capital, for example, has made large investments in portfolio companies where it has been active and very effective at engaging with the company, including in Canada's Turquoise Hill. The second group of new activists included major, traditionally passive investors like T. Rowe Price, AllianceBernstein, Appaloosa Management and Senator Investment Group; who have all begun to directly express their frustrations over governance shortcomings and underperformance at some of their portfolio companies. Over the years, there have been many predictions that institutional investors would become more central and vocal players in the corporate governance paradigm. We are seeing that play out most recently with T. Rowe Price announcing its investment philosophy on shareholder activism, which stated that T. Rowe Price would not need an activist middleman to express disappointment with the performance or poor corporate governance of one of its portfolio companies. Similarly, Appaloosa and Senator have teamed up in a letter campaign at Allergan to suggest a number of needed changes to the company's management, board, and operations. As traditionally passive investors become more willing to issue opinions and demands, you will see activists and companies vying for the support of these quasi-activists.

The hot market in M&A transactions has also contributed to the growth of activism this year as activists seek to both catalyze deal activity and intervene in transactions that lack the proper rationale or valuation. Carl Icahn has been particularly vocal in this respect, opposing tie-ups between Xerox and Fujifilm, SandRidge Energy and Bonanza Creek, and recently Cigna and Express Scripts. With the M&A market still booming, expect activists to continue intervening in announced deals and nudging companies to undertake strategic reviews that will lead to profit opportunities through dealmaking.

Finally, there was a down trend in proxy fights during 2018's proxy season with settlements returning to favor. However, the decisive proxy contest wins that Elliott had at Telecom Italia, Icahn had at SandRidge, and Voce Capital had at Natus; perhaps left a number of activists wondering if they settled for less board seats or concessions than they could have won by going all the way to a vote.

Skroupa: Which of these strategies are we most likely to see activists employ successfully in Canada?

Crawford: While M&A activism in Canada has occurred at a pace roughly on par with prior years in the first half of 2018, investors' renewed interest in the basic materials and energy sectors could bolster M&A activism in Canada moving forward. Activists may see size as a way to strengthen basic materials and energy companies in an environment characterized by uncertain commodity prices, trade tensions. The consolidation trend is beginning to play out in the Canadian gold mining industry now as Paulson & Co. secured a board seat at Midas Gold and is running a full-slate campaign at Detour Gold, where Coast Capital joins Paulson in calling for the company to pursue a sale of itself.

Activists, however, are looking for M&A transactions that make sense over the long-run. This was recently demonstrated when Mittleman Brothers applauded Aimia Inc. for shrugging off an undervaluing offer from an Air Canada-led consortium for its Aeroplan rewards program. Mittleman Brothers encouraged Aimia to pursue its strategy until an offer more reflective of the Aeroplan business appears. An activist discouraging a deal in Canada is far from uncommon considering between 2010 and 2016, 45% of Canadian M&A activism was intended to prevent deals while the United States saw just 21% of its M&A activism focus on deal prevention during that period. The amount of Canadian M&A activism campaigns are demands for deal prevention suggests that the Canadian M&A market is producing too many "friendly" deals that fail to satisfy all shareholders and that deal processes should continue to be carefully scrutinized in Canada.

In the days ahead, look for shareholder activists to show an increased interest in catalyzing or even sourcing M&A deals involving Canadian companies—most likely with a focus on natural resources and real estate-driven companies—and other activists will be watching to insure that Canadian M&A deals are sensible and priced appropriately.

As is the case in the United States, part of the uptick in Canada's general activism campaign volume is the trend of insiders turning to the activist approach at their current or former company. In the first half of 2018, insiders, often founders or ex-CEOs, accounted for half of the Canadian proxy contests. This year, insiders have had mixed success with the founder returning to DavidsTea to win all seven contested seats on an eight-seat board and the former CEO of Colorado Resources Ltd. sweeping all five seats at that company via settlement. On the flip side, insiders were shut out at Alexandria Minerals Corporation and Glance Technologies Inc. showing that insider campaigns for board control are often an all-or-nothing proposition where shareholders must choose between two alternative visions for the company's future. Don't be surprised to see the trend of insider activism continue at Canadian micro and small cap companies.

Skroupa: With M&A activity booming, what role have activists played in the M&A space this year? What are the various M&A strategies activists employ?

Crawford: As mentioned earlier, activists are serving as catalysts, encouraging companies to hire independent financial advisors and set up special committees to launch sale processes; activists are monitoring transactions by advocating for higher, fairer company valuations and by insuring that the deal process is not marred by conflicts.

You see activists taking a stance on the pricing of a lot of transactions this year, most often advocating for increased consideration from acquirors or bidders. But activists are also calling out transactions that do not have a strong combination thesis or arise from a questionable process. In the US, Carl Icahn voiced his opposition to a tie-up between Cigna and Express Scripts due to competitive and regulatory pressures. And earlier this year, Icahn played a central role in shutting down both the conflict-laden Xerox-Fujifilm merger and the head-scratching proposed merger between SandRidge Energy and Bonanza Creek considering both companies had only recently emerged from bankruptcy. Icahn is not the only voice opposing M&A deals this year, but the coverage he has drawn goes to show that activists aren't letting a booming M&A market be an excuse for the occurrence of low-synergy deals, improper transaction valuations, or conflicted bargaining processes.

Another major trend in M&A activism is calling for companies to monetize real estate or non-core assets and spin-off businesses to fund investment in a company's core operating activities. This is happening at Hudson Bay, where Land & Buildings has run proxy contests at Hudson Bay two years in a row. Land & Buildings continues to push Hudson Bay to unload its European operations and real estate as a move towards emphasizing their position in North America, and recently Hudson Bay signed a letter of intent with Signa to accomplish this very step. Expect more real estate-driven activism in the years ahead.

Skroupa: Are more companies being targeted by multiple activists?

Crawford: Companies are progressively more likely to find multiple activists on their shareholder register as more investors adopt activist methods. Investors are entrusting activists with more capital to deploy, so two or more activists identifying the same large or mega cap company to build a stake in, is increasingly common. The fact that an activist is already campaigning at a company is unlikely to be a deterrent to a mature activist hedge fund when its value investing principles suggest such company is a sound investment that offers avenues for value creation.

There has long been a fear of wolf packs, or a group of activist funds who team up and combine their voting power to effect drastic changes at a company. This fear rarely becomes a reality as activists are generally independent in their thinking and competitive by nature, particularly when it comes to established activists with the capacity to build a meaningful position on their own. Rather, multiple activists will build a stake in a company based on their independent investment theses and then have to contend and communicate with each other as well as the board and management of the stake company. This dance played out at Newell Brands when Icahn interrupted Starboard's contest for total board control. The activists were pitted head-to-head with divergent interests before both activists settled for board seats positioning the activists' director appointees to decide on how to revamp Newell from the boardroom. On the other hand, we co-counseled on the successful multi-activist campaign in Canada last year where FrontFour and Sandpiper joined forces to place three representatives on the board of Granite REIT and remove the Chairman and Vice-Chairman.

The two examples above go to show that the dynamics between and interests of multiple activists at the same company may vary greatly along the spectrum from divergent to independent to cooperative.

Skroupa: What are the added considerations when you are advising an activist when another investor or activist is pressuring the target company to make changes?

Crawford: There are many additional and complex considerations when multiple activists target the same company. Chief among them is the delicate balance between determining what role the other activist is looking to play and what their investment thesis is, without inadvertently forming a group. Because communications between funds who have not teamed up are restricted, there is a complicated dynamic trying to establish whether the other activist will successfully achieve the changes the first activist believes necessary at the target. In that case, an activist may choose to bow out, whether the two activists have similar strategies and a partnership makes sense to enhance their impact, or whether they have different approaches and each may want to proceed pursuing their own objective. In the latter case there is the danger that a targeted company may tactically play one activist against the other naturally choosing to cooperate with the one who is less aggressive in their views. This may result in half-measures to address problems at the target and does not necessarily bring about the best outcome for shareholders.

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ABOUT SKYTOP STRATEGIES

As the corporate landscape evolves around global, social, environmental and economic change, **Skytop Strategies** works to facilitate discussion around corporate strategy with C-suite leaders, institutional investors, boards of directors, stakeholders, and authoritative NGO/government agencies. Skytop Strategies convenes companies through **live conferences** designed to empower success and longevity within their respective industries and around the global marketplace. We provide a platform for market-moving dialogue by connecting decision makers through actionable exchange, revolutionizing the way 21st century companies create value. Our programs form an arena for experienced professionals to navigate large-scale concepts and implement sustainable, ethical and productive practices. Topics cover shareholder activism, ESG and sustainability, governance and risk, gender equality, and much more. Skytop Strategies also produces **high-quality content** – interviews, newsletters, feature-length articles, etc. in the form of video, online, print and more – to expand the dialog and support the concepts.

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