

# Activism, M&A, and Effective Shareholder Engagement

Activist shareholders have been taking an increasingly prominent role in the European M&A ecosystem over the past several years. According to data compiled by Activistmonitor, nearly 30% of live activist campaigns in 2017 and approximately 25% of the same in 2015 and 2016, respectively, have involved demands related to M&A and related strategic alternatives.

12 March 2018

As isolated events these situations may not suggest a widespread threat to Boards, but as a collective phenomenon they represent an increasingly potent influence on corporate behaviour. Companies, and boards in particular, need to rethink their investor engagement strategies to mitigate these costly risks to reputation and strategic plans. This is particularly true for the non-executive members of the Board who need to demonstrate the effective stewardship and executive empowerment necessary to win over doubting shareholders.

## RECENT NOTABLE ACTIVIST/M&A ENGAGEMENTS

### SANDELL ASSET MANAGEMENT

attempt to pressure Tesco into increasing the dividend paid to Booker shareholders upon completion of the transaction

### THE CHILDREN'S INVESTMENT FUND (TCI)

fought a pitched battle to prevent Safran from acquiring Zodiac Aerospace

### CLARIANT

abandoned its plans to merge with Huntsman following opposition from US-based Corvex Management

### ELLIOTT MANAGEMENT

waged an aggressive campaign at AkzoNobel over the company's rejection of an acquisition proposal by PPG.]

## Setting Goals, Finding Targets: Activist Approaches to M&A

The activist approach to corporate M&A is varied and ranges from outright opposition on one extreme to effectively forcing a transaction on the other. In between the poles are tactics such as attacking the transaction consideration of an announced deal in order to effect a change in either offer price (e.g. "bumpitraging") or structure (e.g. Elliott, et al. campaign for a structural change to the Anheuser-Busch InBev / SABMiller merger consideration) or support for an unsolicited or hostile bid<sup>1</sup>. In almost all instances, however, activist behaviour with respect to M&A is motivated by the activist's fundamental analysis of what kind of corporate action will generate the highest return for them and 'other shareholders'.

Against this backdrop, the implications for Boards are challenging. Many activists will adopt subtler approaches that require boards to think carefully and critically about their investor engagement on corporate strategy and capital allocation, particularly with their long-only shareholders. How the company engages with an activist, should one emerge, and how it is escalated and effectively managed within the company, will be critical to a successful outcome. Further, which roles will be played by the CEO, Chairman, Investor Relations team, and General Counsel / Corporate Secretary are essential judgements in this process and will be influenced by a wide range of factors.

It is important to note in this context that while activists (particular those with an operational focus) often have relatively long-term time horizons for their investments, the underlying approach of a value-oriented activist is different from many institutional investors. On this basis, how an activist assesses M&A against the range of strategic and capital allocation options may not necessarily be the same as an investor who invests in a company for its steadier low-risk growth and dividend payout. The same distinction can be made for the arbitrageurs who will pile into a company's shares with a view to maximizing event driven returns. This speaks to the importance of using candid, ongoing dialogue to gain support for a company's corporate strategy and capital allocation priorities *before* an activist shareholder emerges on a register to either advocate for, or agitate against, an M&A transaction.

<sup>1</sup> Further, jurisdictions such as Germany offer unique opportunities for activist funds to pit statutory public company takeover "squeeze out" provisions against minority shareholder protections by acquiring shares in a target company and then litigating for a higher consideration after the deal has already been completed.

## Cultivating Support: Strategies for Board Engagement

Bearing in mind restrictions around sharing material non-public information, it is critical that companies clearly articulate their strategic and capital allocation framework to investors on a regular basis and engage in a meaningful discussion about the wide range of options and outcomes that may need to be explored to generate superior returns. While investors may at times challenge the company's views, a mutual understanding between the parties will give investors the facts required to objectively assess the validity of a company's proposals against other alternatives.

As a result, all the evidence points to the best results being achieved by the wider Board investing in both proactive governance and stewardship discussions as well as thoughtful advice on handling the activist engagement when it emerges. In higher risk situations, e.g. M&A and strategic or management change, good advice and support ahead of time can ensure a company is well prepared for any outcome.

The importance of establishing an effective ongoing governance dialogue becomes particularly profound during periods of underperformance, where the company has to make a credible case to investors that it will be able improve returns and meet (or exceed) market expectations over time. Likewise, should the board collectively decide to take a corporate action that would change its investment, risk and return profile – e.g. shifting cash previously allocated for a dividend payout to M&A; unexpectedly diversifying by buying a “non-core” business; making an acquisition that will be dilutive in the near-term – it must have established pre-existing credibility with its investors and a general understanding of how they may react to such a change. Only by doing so can a company demonstrate the stewardship and empowerment necessary to mitigate the risk of negative surprises for both the board and the investors.

The importance of a robust ongoing dialogue between issuer and investors on these matters becomes immediately apparent in the event an activist investor takes a view, public or private, on M&A. If a company facing activist pressure has done the work with its institutional investors before the activist emerges – and those investors are confident that the Board's governance structures do not impede its ability to be an honest arbiter of value – it will benefit from both the goodwill and informational parity it will have created prior to the challenge. If this does not exist, then the company will immediately be in the disadvantaged position of having to defend its strategy against the activist thesis. The consequences of being forced to do so are not always immediate, but can be far reaching with implications beyond the parameters of deal-making.

## Vested Interests: The Consequences of Cross-Shareholdings

This theatre becomes more complicated in instances where there are significant cross-holdings in the share registers of an acquirer and its named or potential target, and even more so in cases where the activist holds shares in both companies and tries to take a seat at the deal table. In the US, this issue came into focus in 2014 when Valeant failed in its attempt to acquire Allergan. Activist hedge fund Pershing Square was both a “co-offering person” with Valeant and a holder of Allergan shares it accumulated in the run up to Valeant making its acquisition proposal. While allowed at the time, it did not pass the smell test. A subsequent settlement in which Pershing Square and Valeant agreed to pay almost \$300 million rather than litigate after a court found that it had unlawfully accumulated Allergan shares while knowingly in possession of material nonpublic information shows that it could not withstand a sterner test of whether the joint Valeant / Pershing Square bid ran afoul of insider trading rules.

While the Valeant “joint” bid with Pershing Square may be an outlier, the value arbitrage play that occurs when both an activist and institutional investors own shares in both an acquirer and seller creates significant complexity for the company that is targeted by the activist. In this case, the company targeted by the activist faces a stern burden to make a compelling case for its preferred strategic alternative likely in the heat and light of what is likely by this stage a publicly scrutinized situation and with a shareholder base that may rapidly change as event driven arbitrageurs enter the stock.

At this late stage the reputational risks are higher than they need be, unless the ground has been laid effectively beforehand. The company must be prepared to engage directly and substantively with both the activist and institutional investors (and to a certain extent other relevant third parties such as the financial media) about the merits of an announced but opposed acquisition, decision to reject an unsolicited bid, or proposed transaction consideration. Ideally, this shareholder engagement will be built on the foundation of the ongoing dialogue discussed above as investors will have the implied value of the company's long-term strategic plan as their predicate when analyzing the situation. Absent this pre-existing understanding, the pressure on the company to win over investors in a short period of time and against a well-armed and prepared activist, can be overwhelming.

## In conclusion

It is difficult, if not impossible, to address the varied nuances of the impact that activist investors are having in the sphere of M&A in a short paper. Regardless of the specifics of a situation, all outcomes are likely to be improved if company boards are effectively engaged in meaningful dialogue with their investors on governance and stewardship, alongside the management team's investor relations activity, in order to maximise their reputation to make rational, long-term value-based decisions around M&A strategy.

## CONTACTS

### John Dawson

Partner  
t: +44 (0) 20 3948 1476  
e: [john.dawson@staterallp.com](mailto:john.dawson@staterallp.com)

### Michael Henson

Partner  
t: +44 (0) 20 3948 1476  
e: [michael.henson@staterallp.com](mailto:michael.henson@staterallp.com)