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# M&A ACTIVISM 2019

PRODUCED BY

Activist Insight

# CONTENTS

## M&A ACTIVISM 2019





# FOREWARNED

In the more than two years since Activist Insight's last report on M&A activism, the landscape has changed in many significant ways, writes Activist Insight's editor-in-chief, Josh Black.

Take as your starting point the second half of 2018 and M&A activism has apparently swung violently from enjoyment of last year's record M&A volumes to a trend of opposing large-cap transactions. Cigna and Dell highlighted the trend in the second half of 2018, and this year's prime specimens – Bristol-Myers Squibb and Occidental Petroleum – provide lessons because of the lengths to which activists and traditional asset managers went in protesting them.

The emergence of traditionally silent market participants as sometimes vocal activist allies has been another key talking point in 2019. They have lent credibility to activist arguments when suspicions have been raised – sometimes without evidence – about activists' trading activity. Thanks to the deteriorating deference paid to management teams, proxy advisers are important gatekeepers. Few deals have been troubled that were blessed by Institutional Shareholder Services and Glass Lewis, but activists have also made deep impressions with increasingly sophisticated analyses.

While opposition to M&A has indeed spiked from the U.S. to Europe, support for M&A remains a more common strategy for value creation. Some opposition to acquisitions is merely a prelude to a sales process, although a sound standalone strategy is a must-have for such campaigns to succeed.

Then there is the direct approach. Elliott Management's expansion of its private equity arm in late 2017 fired the starting gun on a new phase of convergence, collaboration, and competition with private equity. Twelve takeover bids were made by hedge funds in the first six months of 2019, equalling 2018's record, according to *Activist Insight Online*.

Overall, takeover demands are at their highest level since at least 2013, despite much higher valuations. As Skadden, a sponsor of this report, points out in an interview within these pages, private equity strategies provide flexibility for funds lucky enough to have long-term money but raise questions about their alignment with other market participants.

Indeed, as noted by our other sponsor, MacKenzie Partners, the flexibility of M&A activism – its ability to shift between different types of demands, taking different sides of deals – is a reason why it can flourish at any point in the economic cycle. M&A activism may need M&A but doesn't need much else to thrive.

We have divided this report up into thematic sections, highlighting new developments as well as lessons in how to defend against M&A activism. We hope its findings, including data on the many strands of this complicated strategy, are helpful to practitioners on all sides.

Our thanks go in particular to our sponsors, Skadden and MacKenzie, but also to all those who agreed to be interviewed over a summer in which there were distinctly few breaks from M&A activism.

Rapid growth in the number of investment banks offering corporate defense services to companies speaks to how intertwined the worlds of activism and M&A have become. The fact that a select number of investment bankers have moved the other way, most recently with Goldman Sachs' Steven Barg joining Elliott, merely reinforces that point.

This is likely the first special report in a bumper few months for Activist Insight and we are planning an expanded roster for 2020. If you would like to suggest a topic or participate in a future publication, please do get in touch.

*Note: Data throughout this report is as of June 30, 2019, although anecdotes and interviews may have taken place later.*

# STOP THAT DEAL

With M&A activity on the rise, activists are not only hunting for the proverbial price bump but also opposing deals on strategic grounds, writes Iuri Struta.

When Starboard Value invested in Bristol-Myers Squibb with the stated intent of blocking the latter's takeover of Celgene, it seemed like a manifestation of activists' growing desire to shape the U.S. corporate landscape. The hedge fund's subsequent failure to do so showed their limitations.

In that respect, Starboard is by no means alone. Later in 2019, both Pershing Square Capital Management and Third Point Partners expressed opposition to United Technologies' plans to acquire Raytheon with stock, although the former exited in protest. Carl Icahn unsuccessfully campaigned against Occidental's buyout of Anadarko Petroleum and is now pursuing board seats.

> "Activists' track record in stopping deals counts for little, given the specificity of each situation."

One of the reasons activists have struggled may be that, with the growth of passive investing, deals are evaluated as a whole, rather than from only one side of a transaction. "It's important when looking at a deal to understand the economic crossownership at the fund level," says Pete Michelsen, head of activism and shareholder advisory for the Americas at Goldman Sachs. "An investor that may be on the fence on the buyside could be receiving a premium on the seller's side."

Advisers interviewed for this report said activists' track record in stopping deals counts for little, given the specificity of each situation. "Activists tend to be a pretty confident bunch and I suspect most of them think that they would have different success in other campaigns," David Rosewater, global head of activism defense at Morgan Stanley, told Activist Insight.

> "The problem of when you are attacking an acquirer is that the campaign is certainly more amorphous."

Indeed, 18 U.S. companies have seen their deals opposed in 2019 so far, the highest number in the opening six months of the year since at least 2013. Europe, a historically fertile ground for bumpitrage campaigns, experienced a resurgence of these kinds of demands, with eight companies targeted in the first half of 2019 – already close to the 10 registered in the entire of 2018. In 2019, globally, 33 deals were opposed, nearing the record of 35 reached in the same period of 2016, although opposition to deals was lower in Asia, and Japan than recently (see charts overleaf).

## Questioning the bidder

While in Europe most of the activity centered around squeezing out higher prices from the bidder, the U.S. increasingly saw activists questioning the strategic rationale of the acquirer.

A favorable environment marked by falling interest rates, high equity valuations and plentiful cash from U.S. tax reforms has created opportunities for companies to boost earnings growth through mergers. Averse to empire-building and keen on more focused companies, shareholders have started to rebel.

At the same time, deals are increasingly questioned not only by dedicated activists but by traditional investors, part of a broad trend of institutional investors becoming more vocal with their shareholdings. So far this year, five companies have seen opposition from institutional investors that do not typically engage in activism.

"You can't ignore any of your top shareholders anymore. It's not just waiting for an Icahn," Christopher Ludwig, head of shareholder advisory and M&A at Credit Suisse, told Activist Insight.

"You see a convergence of the trends on opposing M&A and typical institutional investors who don't use activism coming out more regularly," Rosewater agreed. Wellington Management backed Starboard in its opposition to Bristol-Myers' deal, while the tie-up between Occidental and Anadarko stirred the public anger of T. Rowe Price. In Europe, Fidelity International and Legal and General joined activist Odey Asset Management in demanding a higher price for their shares in Acacia Mining.

## Mixed record

Of the 54 U.S. cash-only deals that have seen opposition since 2013, over half proceeded unamended and 19% were canceled, according to *Activist Insight Online* data. In Europe, 29% of the 34 cash-only deals opposed by activists since 2013 completed in their original form, with the rest either abandoned or changed. In part, that may be because minority shareholders are afforded more protections in Europe.

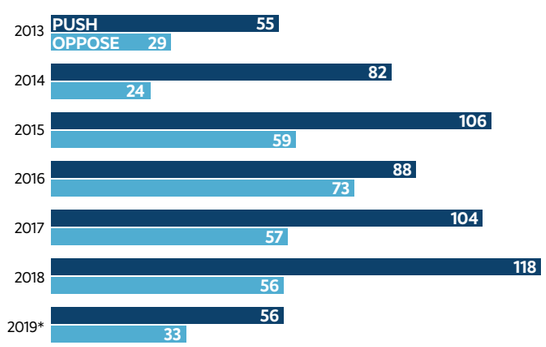
In the U.S., not all acquirers provide a shareholder vote, as in Occidental's purchase of Anadarko. Moreover, pressure is higher on the activists to show there are better options when they try to scuttle a deal than when they ask for a price increase for the buyout target. For one thing, it is more difficult to convince proxy advisers Institutional Shareholder Services and Glass Lewis, particularly if there is no clear affront to corporate governance best practices.

> "Averse to empire-building and keen on more focused companies, shareholders have started to rebel."

"The problem of when you are attacking an acquirer is that the campaign is certainly more amorphous. Even though the math may be black and white on a spreadsheet, it's harder to translate that into an effective campaign," Darren Novak, global head of activist defense at UBS, said in an interview for this report.

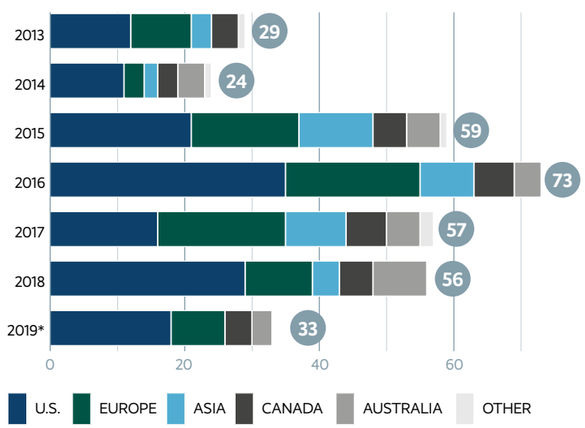
Activists have tried to resolve the problem of upside visibility by promising a sale, with mixed success. Icahn, for instance, successfully stopped Xerox and SandRidge Energy completing their respective deals with Fujifilm and Bonanza Creek Energy in mid-2018, while Corvex Management and 40 North blocked Clariant's takeover of U.S. peer Huntsman. All three campaigns had unique circumstances that helped the activists win, but each promised to ultimately sell the company and failed.

### PUSH & OPPOSE M&A TARGETS




NUMBER OF COMPANIES GLOBALLY PUBLICLY SUBJECTED TO M&A-RELATED ACTIVIST DEMANDS BY DEMAND TYPE AND YEAR. *2019 AS OF JUNE 30, 2019.
SOURCE: ACTIVIST INSIGHT ONLINE

### OPPOSE M&A TARGETS BY GEOGRAPHY




NUMBER OF COMPANIES PUBLICLY SUBJECTED TO OPPOSE-M&A ACTIVIST DEMANDS BY YEAR AND COMPANY HQ. *2019 AS OF JUNE 30, 2019.
SOURCE: ACTIVIST INSIGHT ONLINE

# WORK OF ARB

While the U.S. has seen a larger number of activist demands for higher takeover prices over the past five years, European campaigns have offered higher bumps more often, writes Iuri Struta.

Bumpitrage, whereby activist investors ask bidders for a "bump" in the price being offered for a target, grew out of event-driven, or arbitrage strategies. Better protections for minority shareholders and bigger valuation gaps have made the strategy popular in Europe, as well as in North America.

Indeed, with a larger number of deals and a longer history of shareholder activism, the U.S. has seen more demands for price bumps in recent years than Europe but a lower rate of success. Of the 54 U.S. cash-only deals opposed by activists between 2013 and end of June 2019, 15 experienced a price bump (deals with an equity component were excluded). In Europe, 17 of 34 opposed deals saw a hike in the offer, data from *Activist Insight Online* show.

**"While the U.S. has seen a larger number of activist demands for higher takeover prices over the past five years, European campaigns have offered higher bumps more often."**

## Bargainland

Bumpitrage has proved a more lucrative strategy in Europe, too. The average increase in deal price was 9.1% across all Europe-based companies publicly subjected to M&A opposition, and 16.3% for the subset that were amended. By contrast, the average across all deals was only 2.7% in the U.S., or 9.0% for amended deals.

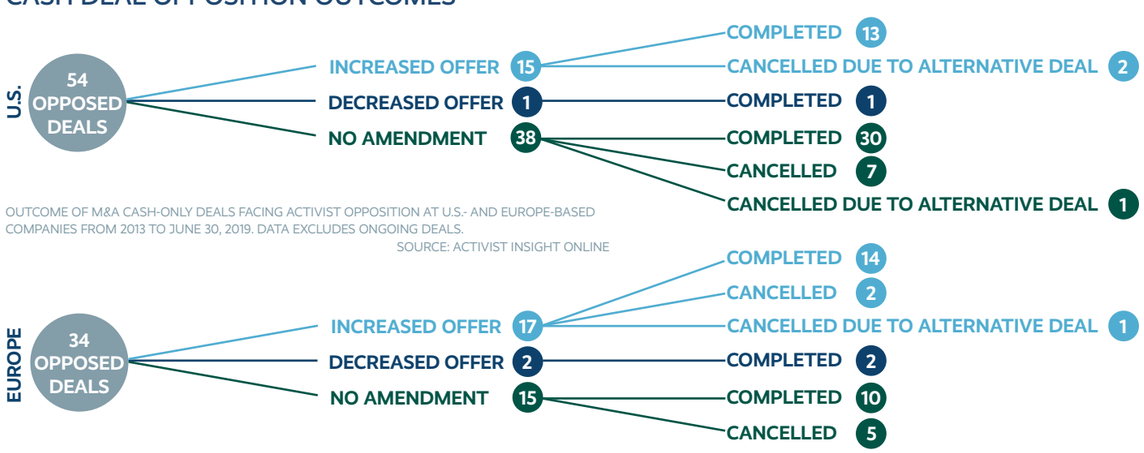
Diverging valuations between the U.S. and European markets, as well as better protections for minority shareholders in certain jurisdictions such as Germany and the U.K. could explain why opposed deals experienced a higher bump in Europe. "When you have more frothy valuations in the U.S., there are fewer questions of disparate value," Darren Novak, global head of activist defense at UBS, said in an interview for this report.

Till Hufnagel, a partner at Petrus Advisers, which most recently participated in a bumpitrage campaign at Ophir Energy, concurred. "We are quite stunned how low valuations have fallen in Europe," he told Activist Insight.

## When they go low, we go high

Like other forms of activism, dissidents often succeed by convincing other shareholders that management has wronged them. "Often an unfair price is mixed with bad corporate governance," Catherine Berjal, the co-founder of French activist fund CIAM, which according to *Activist Insight Online* has opposed four deals since 2013, said in an interview.

## CASH DEAL OPPOSITION OUTCOMES




OUTCOME OF M&A CASH-ONLY DEALS FACING ACTIVIST OPPOSITION AT U.S.- AND EUROPE-BASED COMPANIES FROM 2013 TO JUNE 30, 2019. DATA EXCLUDES ONGOING DEALS.
SOURCE: ACTIVIST INSIGHT ONLINE



Indeed, a strong founder or a take-private deal by a major shareholder can be an ideal target for a bumpitrage campaign. Carl Icahn fought twice with Michael Dell over the latter's eponymous computing giant: a take-private deal in 2013, and last year when it went public again through a merger with VMWare. In both cases, Icahn exacted more money but walked away feeling he and other shareholders deserved better.

Having the wherewithal to mount a rival bid, as Icahn did in 2013, can also be an advantage to a dissident. In recent weeks, The Catalyst Capital Group launched a tender offer for 10% of Canada-based retailer Hudson's Bay Company at a higher price than that offered by a management buyout group. It remains too early to predict the ultimate outcome but Catalyst's tender succeeded.

**"Holding out against a tender is another strategy, although such campaigns require a large war chest, patience, and legal expertise – a combination few funds have."**

Holding out against a tender is another strategy, although such campaigns require a large war chest, patience, and legal expertise – a combination few funds have. Elliott Management has developed a profitable niche in Europe by taking large blocking stakes in takeover targets and refusing to tender its shares until the price is increased.

At Italy's Ansaldo STS, Elliott achieved success in 2014 after three years of court battles with bidder Hitachi. At Kabel Deutschland, the activist remains a large investor six years after investing with the intent of getting a higher price from Vodafone. Much quicker was the resolution of Elliott's stance at Germany's generic drugmaker Stada in 2018, when private equity firms Bain and Cinven purchased Elliott's stake at a premium to the original proposal.

## Sky's not the limit

One of the largest bumpitrage situations in recent years was at U.K.-based cable-TV company Sky. Funds such as Odey Asset Management, Jupiter Asset Management and Polygon came out against minority shareholder 21st Century Fox's full takeover bid for Sky in December 2017, which was to take place before Fox itself was acquired by The Walt Disney Co. Elliott also appeared on Sky's share register the following month.

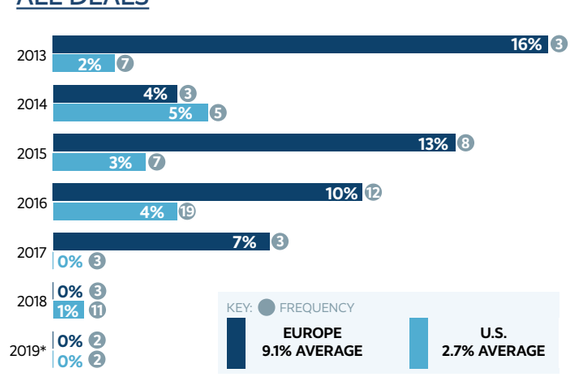
"We thought the offer was low, but we were very confident that the price would be increased," Berjal, whose CIAM was a shareholder at the time of Fox's 10.75 pound per share offer, said.

Elliott and other shareholders such as Davidson Kempner and Farallon Capital hired Greenhill & Co. to assist them with persuading British regulators that shareholders were being short-changed in light of the Disney bid. Yet the arrival of Comcast as an alternative bidder made their job much easier and was likely an unexpected bonus for the activists.

"When rumors on Comcast came out, we actually increased our position," Berjal told Activist Insight.

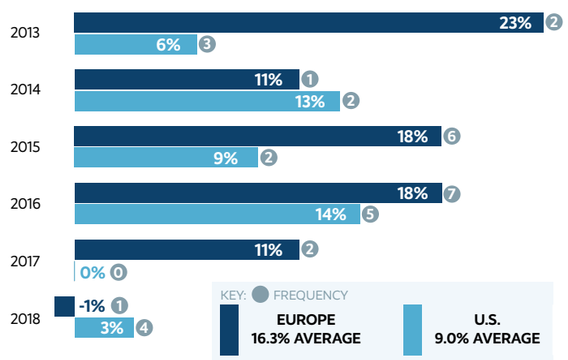
Over the following months, the cohort of activists in Sky watched from the sidelines as the bidding war between Fox and Comcast eventually led to victory for the latter and a final price of 17.28 pounds per share, more than 60% higher than the initial offer.

## PRICE INCREASES IN OPPOSED TAKEOVERS ALL DEALS




AVERAGE OFFER PRICE CHANGE IN CASH ONLY TAKEOVER DEALS OPPOSED BY ACTIVISTS, INCLUSIVE OF OFFERS THAT WERE WITHDRAWN BUT MAY HAVE BEEN AMENDED, DATA EXCLUDE ONGOING DEALS. *2019 AS OF JUNE 30, 2019.
SOURCE: ACTIVIST INSIGHT ONLINE

## AMENDED DEALS ONLY




AVERAGE OFFER PRICE CHANGE IN CASH ONLY TAKEOVER DEALS OPPOSED BY ACTIVISTS, INCLUSIVE OF OFFERS THAT WERE NOT COMPLETED BUT WERE AMENDED, EXCLUSIVE OF ONGOING DEALS AND ANY DEALS THAT DID NOT RECEIVE A CHANGE IN CONSIDERATION.
SOURCE: ACTIVIST INSIGHT ONLINE

# DELIBERATE PROCESS

An interview with Richard Grossman, partner in Skadden's M&A practice and expert on shareholder activism.

### Should companies structure M&A to avoid an acquirer's shareholder vote or is that likely to cause problems later?

Structuring an M&A transaction requires careful consideration of a number of important factors, including not only shareholder approval requirements, but also, among other things, the transaction's impact on existing agreements and rights and the need for third-party consents, debt structure, transfer of liabilities, timing, efficiency and execution risk, and tax and accounting considerations. While there may be benefits to structuring a transaction in a manner that does not require an acquirer's shareholder vote, boards of directors and management teams must carefully balance all of these factors in the context of considering a specific deal.

Further, the absence of a need for shareholder approval does not insulate an acquiring company or its board of directors and management from activist scrutiny, as we have recently seen in the case of Carl Icahn's campaign at Occidental Petroleum: while Occidental's transaction to acquire Anadarko Petroleum did not require a shareholder vote as a result of the portion of the deal consideration represented by common stock, Icahn responded by launching a campaign to replace four of the company's directors and amend certain provisions of the company's governing documents to allow stockholders' ability to act by written consent and call special meetings.

> **"The absence of a need for shareholder approval does not insulate an acquiring company or its board of directors and management from activist scrutiny."**

### How can companies best prepare for activism and maximize their chances of getting a deal done?

Companies should regularly evaluate their businesses and assets, assessing whether the current strategic plan is the best path for driving shareholder value or whether there are additional opportunities or more attractive alternatives. A board of directors, working with its management team and advisers, can then proactively pursue an appropriate path "acting as its own activist."

In considering whether a strategic transaction is the best way to drive value, the board should go through a deliberate review process, considering the merits and risks of the transaction and available alternatives. The ability to articulate a cogent transaction rationale and to show that the transaction was the result of a thoughtful process undertaken by the board with the assistance of financial and legal advisers, and aimed at creating value for shareholders, is often critical in winning support for a transaction.

The transaction parties need to assess in advance likely shareholder reaction and seek to identify potential criticism from activists regarding the strategic rationale, price, terms or process and prepare to rebut that criticism. Companies also benefit from having ongoing communication with the market regarding corporate strategy, including overall M&A strategy. By providing opportunities to have a dialogue with shareholders in advance, the company is in a position to consider the ideas and perspectives of key shareholders when making decisions related to major transactions.

### Is private equity capability an advantage for activists or a potential conflict of interest?

The capacity and willingness to offer to pivot to a private equity strategy can provide an advantage to an activist when approaching boards of directors who will be cognizant of the fact that the activist has the ability to buy the company, and may impact how boards engage with the activist. The ability to pursue alternative courses of action may also provide the activist hedge fund with greater optionality. At the same time, this strategy may raise the concern of conflicts where, for instance, an activist hedge fund agitates for the sale of a target company and then participates or leads while on the buyside.

### What legal channels are activists most likely to take advantage of?

Activist have a wide variety of tools that they can utilize to cause a company to take action that they are advocating. The "nuclear-option" for an activist is to engage in a full-scale proxy contest either for control of or representation on a target company's board of directors. Activists may also pursue litigation or make a "books and records" demand under state law to pressure (and potentially embarrass) a company.

Further, some companies' charter documents permit shareholders to call a special meeting or act by written consent without a shareholder meeting allowing an activist to remove all or a portion of a company's board of directors, or amend bylaws or pass other binding or non-binding resolutions without waiting for an annual meeting and in the case of a written consent, potentially with minimal notice to the company.

### Do activists initiate more M&A than they chill?

Shareholder activists continue to make M&A a core theme of their campaigns. The first half of 2019 saw 37 U.S.-based companies publicly subjected to activist demands advocating for M&A transactions, while 18 companies faced demands opposing M&A, and an additional 13 were targeted with demands to spinoff businesses or break up. One-third of companies publicly subjected to activist demands by dedicated activists globally included an M&A-related demand, according to *Activist Insight Online*.

Demands by an activist, and even the mere presence of an activist in a company's stock, can impact how and when companies consider engaging in strategic transactions. By demanding that a company consider strategic alternatives, activists may be able to garner support for potential transactions from other shareholders, further increasing the pressure on a company. Also, activists can impact how boards review proposals from potential acquirers, as boards will undoubtedly consider how activists (as well as other shareholders) will respond to the company's acceptance or rejection of an offer.

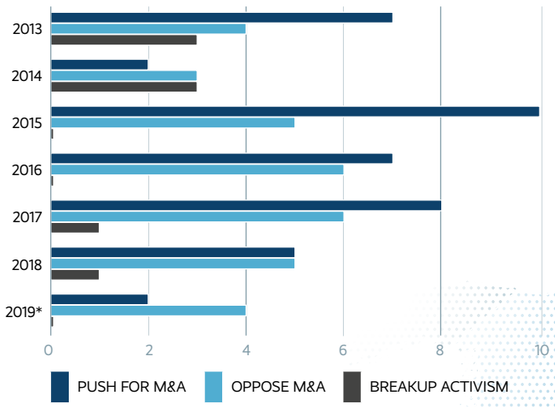
> **"Demands by an activist, and even the mere presence of an activist in a company's stock, can impact how and when companies consider engaging in strategic transactions."**

### Will M&A activism continue to increase?

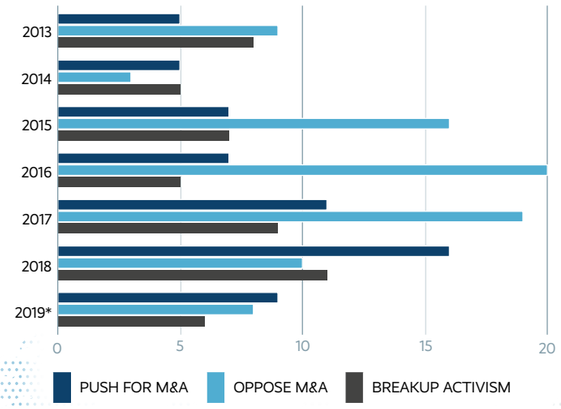
As activism has become a widely accepted strategy to generate "alpha," we expect that activism will continue to have a significant impact on how M&A deals are sourced, how companies respond to advances by third parties and how companies engage with their shareholders in relation to extraordinary transactions. Established activists, newly formed funds and "occasionalists" have all pursued M&A-themed activism campaigns, because M&A has been an attractive avenue to generate return. We have also seen increasing commentary from more traditional "long-only" institutional investors regarding M&A transactions, as was the case with Wellington's recent public commentary on the Bristol-Myers/Celgene transaction. Going forward, it may become more normalized for traditional investors to be more vocal publicly or even to employ more activist tactics to agitate for or against an announced transaction.

# M&A ACTIVISM IN NUMBERS

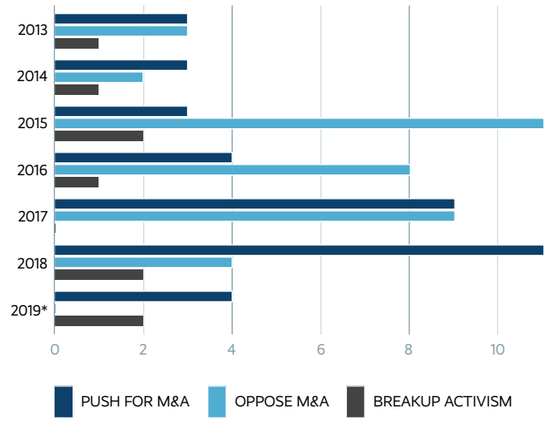
## M&A ACTIVISM IN CANADA




## M&A ACTIVISM IN EUROPE



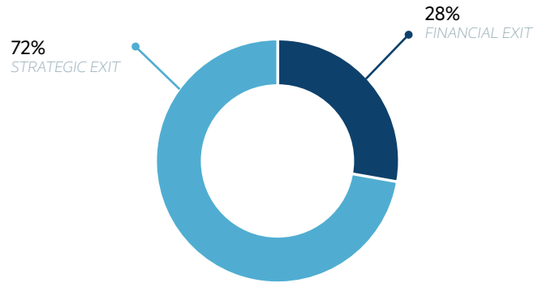

## M&A ACTIVISM IN ASIA




NUMBER OF COMPANIES PUBLICLY SUBJECTED TO M&A-RELATED ACTIVIST DEMANDS, BY COMPANY HQ, DEMAND TYPE, AND YEAR. *2019 AS OF JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT ONLINE

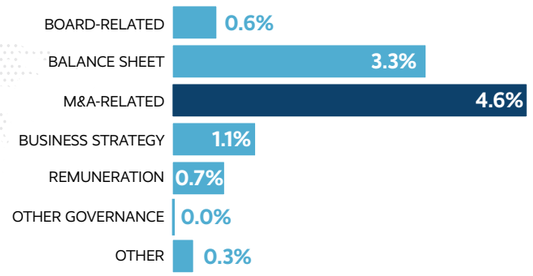
## M&A EXITS OF NORTH AMERICAN ACTIVIST POSITIONS




EXIT TYPE BREAKDOWN OF ACTIVIST POSITIONS EXITED WHERE AN ACTIVIST HAD MADE AN M&A-RELATED DEMAND OF NORTH AMERICA-BASED COMPANIES FROM 2013 TO JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT ONLINE

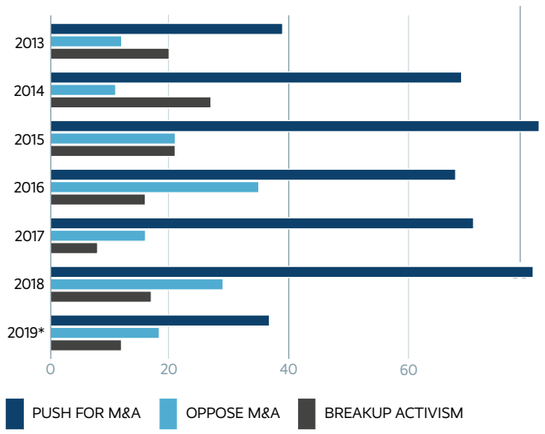
## CAMPAIGN RETURNS BY ACTIVIST DEMAND



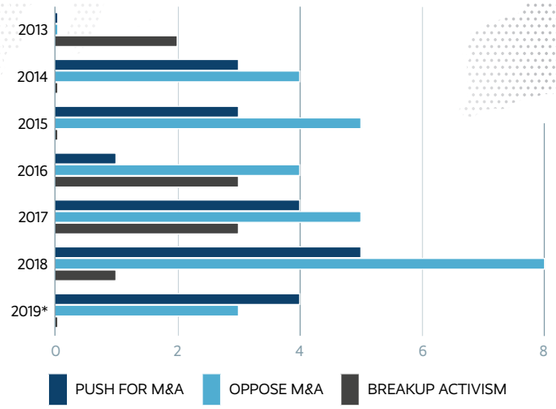

TRIMMED AVERAGE (10%) CAMPAIGN RETURNS** OF ACTIVIST INVESTMENTS BY ACTIVIST DEMAND TYPE FROM 2013 TO JUNE 30, 2019.
**THE TOTAL RETURN (INCLUSIVE OF DIVIDENDS) TO (I) THE CLOSING PRICE ON THE RESPONSE DATE IF THE DEMAND HAS BEEN RESOLVED, (II) THE CLOSING PRICE ON THE DAY THE ACTIVIST DISCLOSED IT HAD EXITED THE STOCK IF THE DEMAND HAD NOT BEEN RESOLVED, OR (III) THE CLOSING PRICE ON JUNE 30, 2019 IF THE ACTIVIST IS STILL INVESTED AND THE DEMAND IS ONGOING.

SOURCE: ACTIVIST INSIGHT ONLINE

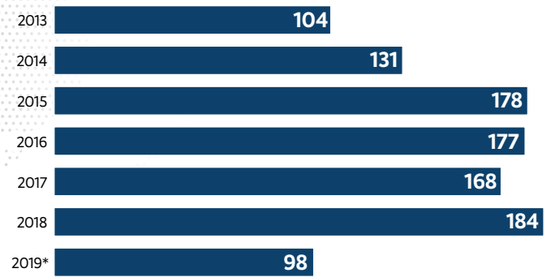
## M&A ACTIVISM IN THE U.S.




## M&A ACTIVISM IN AUSTRALIA




## M&A ACTIVIST TARGETS BY YEAR




NUMBER OF COMPANIES PUBLICLY SUBJECTED TO M&A-RELATED ACTIVIST DEMANDS GLOBALLY BY YEAR. *2019 AS OF JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT ONLINE

# THE ENDS OF DEFENSE

An interview with MacKenzie Partners' managing director, Paul Schulman, and executive vice president, David Whissel, about vocal asset managers, effective defense strategies, and the future of M&A activism.

### Have traditional asset managers become more vocal about deals? Do their voices carry more weight than traditional activists?

Long-only asset managers have always been opinionated regarding companies' transactional decisions. However, most of the criticism took place behind the scenes – with a few notable exceptions. Recently, however, some asset managers have become more comfortable with taking public stances on deals. The most notable example of this occurred at Bristol-Myers Squibb in its acquisition of Celgene, with Wellington Management going so far as to file a Schedule 13D and press release in response to the transaction. One of the most obvious reasons for this is that active managers are increasingly adopting strategies to distinguish themselves from passive investors, who have recently enjoyed the bulk of fund inflows.

From the issuer perspective, dealing with activism from a traditional long-only fund presents a unique challenge. In many cases, these traditional managers have longer holding periods and little (if any) track record of any public activism, which gives them more credibility with some other institutions and proxy advisers.

### Should companies try to structure their deals to avoid a shareholder vote?

Though an activist may try to frame a particular deal structure as simply a tactic to "avoid a shareholder vote," in practice, there are a multitude of factors that issuers and their advisers weigh when determining how to structure a transaction. It is important for a company to be able to articulate the benefits of the deal to shareholders, regardless of the presence of a shareholder vote. An inability to show that the deal was structured to benefit shareholders and not specifically to avoid a vote will likely have long-term consequences.

> **"M&A activism as a whole is a well-worn strategy... Its flexibility means that it can be applied throughout various economic cycles, which makes it ideal for the uncertainty that lies ahead."**

### Why are activists so rarely successful at breaking up announced deals?

First, there is a degree of deference that many investors grant boards and management teams, who have more information to evaluate the merits of a particular deal. Second, shareholders recognize that most deals are carefully evaluated by parties that are well-advised by legal and financial experts; boards of directors are very cognizant of their fiduciary obligations to their shareholders. Third, even if a deal receives vocal shareholder opposition, the parties are generally able to renegotiate the economic terms and make other concessions.

Finally, it's important to remember that an activist's goal may not be to break up a deal, but to extract better terms. Shareholders, including event-driven funds that have no interest in being long-term holders and may agree with the economic arguments of the activist, face the tough choice of opposing a deal that has industrial logic and provides an acceptable (if not maximum) gain versus the risk of the merger being terminated, and they will usually vote in favor of the deal. The tough choice companies make is to hold firm on the original terms versus re-cutting a deal to get it over the goal line. This is where we believe we add particular value in terms of evaluating the likelihood of shareholder approval for a particular deal.

### How should companies structure their outreach campaigns to minimize the risk of activism or maximize their chances of getting the deal done?

Transactions that are most likely to raise opposition from shareholders are unexpected ones. If an activist invests in a particular company with a thesis widely shared by the market that it is a prime takeover target, but the company then unexpectedly announces an acquisition, that disparity between investor expectation and reality can create conflict. Additionally, the price of a deal and its industrial logic are frequent concerns for investors.

> **"It's important to remember that an activist's goal may not be to break up a deal, but to extract better terms."**

With that in mind, communication with shareholders is critical. A strong ongoing investor relations program with management establishing credibility and getting input from shareholder is extremely effective in conveying a company's message to its shareholders and setting expectations. Then, once a transaction is announced, a company should be able to articulate why this deal is the right one, why the timing is appropriate, and how shareholders will realize value as a result.

### What is the best defense against a hostile bidder?

The best and most obvious way to fend off a hostile, opportunistic acquirer is to demonstrate that the target is capable of creating value that is superior to the offer on the table. First, the target should have a well-vetted strategic plan that clearly spells out the potential upside opportunities. Second, the target's alternative plan for value creation must be clearly communicated and be viewed as credible. A company's relationships with its key shareholders will also be critical to the ultimate outcome of the situation. Certainly, one of the best ways for companies to earn the support of their shareholders is through consistent execution of their strategic goals over the long term. A robust shareholder engagement campaign is critical to build credibility among investors and convince them that the company's strategic plan is the best path forward, particularly for companies with less than stellar past performance.

> **"The best and most obvious way to fend off a hostile, opportunistic acquirer is to demonstrate that the target is capable of creating value that is superior to the offer on the table."**

### Is M&A activism likely to increase in the next few years?

In 2019, M&A has been a thesis at around one-third of all companies publicly subjected to activist demands by dedicated activists, and we don't see that trend slowing down. That holds true regardless of the state of M&A as a whole. If M&A activity were to continue to slow down, muted activity can cause activists to become more vocal in criticizing existing deals, either looking for an increase in price or trying to block them entirely.

On the other hand, an active or overheated market has historically prompted an increase in calls from activists for companies to sell themselves. M&A activism as a whole is a well-worn strategy and, perhaps unlike traditional activism, can and has been adopted by a wide range of investors. Its flexibility means that it can be applied throughout various economic cycles, which makes it ideal for the uncertainty that lies ahead.

# SELL, SELL, SELL

Activists may be growing up but shopping a company remains a popular strategy, writes Josh Black.

Around the world, activists are jumping on the M&A bandwagon not just to bury deals but to give them life. Data from *Activist Insight Online* show that public demands favoring dealmaking were on average almost twice as numerous as those aimed at stopping or improving already announced transactions between 2013 and 2018. Breakup campaigns, including the sale or divestment of business units, were excluded.

Moreover, despite the growing appeal of operational activism, a rising number of companies have been publicly subjected to pro-M&A demands, up from 55 in 2013 to 118 globally last year. Data from *Activist Insight Online*'s total campaign returns feature suggest stocks where activists publicly push for M&A rise on average by more than any other kind of M&A demand except direct takeover offers.

"Often, for companies of the right size, the sale of the company is the ultimate win for an activist and is, as a result, a core part of an activist's thesis whether spoken or not," Darren Novak, the global head of UBS' activism defense group, told Activist Insight for this report.

## Age of the understatement

Such data likely understate the true amount of pro-M&A activism.

"You still see those kinds of demands," says Morgan Stanley's head of activism defense, David Rosewater. "But activists over the years have learned that even if that may be their ultimate goal, they may be more successful at influencing shareholders by focusing on other options or issues."

> **"Demanding M&A activity may seem like a typically American form of activism, and the data support that presumption."**

> **"A public announcement may not be the value-maximizing path even if you want to sell yourself."**

While the focal point of a campaign, especially at larger companies, is likely to be capital allocation or operational performance, M&A may be at least a fallback strategy. Opposition to Bristol-Myers Squibb's or Occidental Petroleum's acquisitions came buttressed by suggestions the acquiring companies could otherwise be targets – a proposition that could deliver more value to their shareholders, at least in the short term.

Yet while large-cap M&A garners the headlines, around three-quarters of the companies pushed to participate in M&A have a market capitalization of below $2 billion, according to *Activist Insight Online*. "While there are typically multiple paths to win, for companies that are not mega-cap companies, a significant part of the thesis remains a sale of the company or a significant part of it," Pete Michelsen, co-head of Goldman Sachs' activism defense practice in the Americas added in an interview.

## A global trend

Demanding M&A activity may seem like a typically American form of activism, and the data support that presumption. Pro-M&A activism consistently exceeds opposition or breakup demands in North America, according to *Activist Insight Online*, while in Asia and Europe the balance has whipsawed through the years. Even so, pro-M&A activism remained above average levels in Europe, Asia, and Australia, despite a period of heightened focus.

Successful campaigns grounded in catalyzing a sale have included Whole Foods Market, whose CEO John Mackey called Jana Partners "greedy bastards" while selling up to Amazon in 2017, and Ireland-based drugmaker Allergan, pushed privately by Elliott to explore alternatives.

Earlier this year, California-based hedge fund ValueAct Capital Partners made an unusual public demand for the sale of theme park-operator Merlin Entertainments, carefully suggesting that private equity could better provide long-term investment, and noting the need to divert employees' attention from the plummeting stock price. "While Merlin obviously thrived as a private company, it may have come public too quickly, with too many investments left to make for a yield-focused market," the activist said in a letter. Five weeks later, the company announced a take-private led by Blackstone and the Canada Pension Plan Investment Board.

## Hard sell

Yet success is far from guaranteed. In Europe, AkzoNobel survived calls for its own sale following a sustained legal battle with Elliott Management that highlighted the defenses available to Dutch firms. In the U.K., Burberry and the London Stock Exchange have remained stubbornly independent. Asia has seen only a few successful actions, including at Kuroda Electric, where Yoshiaki Murakami marked his return to activism in Japan.

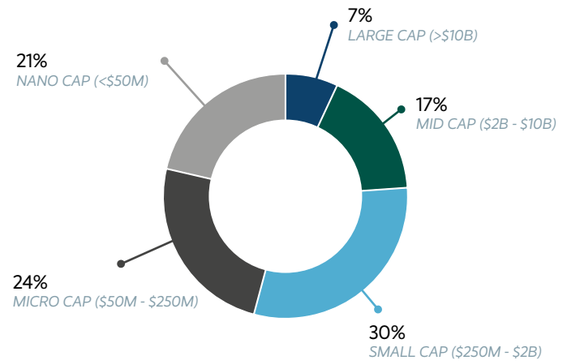
Last year, activists suggested Canadian miner Detour Gold and U.S. food company Campbell Soup should sell but no buyers emerged. "Given the significant obstacles facing [Campbell Soup], [Third Point] believe[s] that the only justifiable outcome of the strategic review is for the issuer to be sold to a strategic buyer," Dan Loeb's fund said in its first regulatory filing at the company. It subsequently dropped the claim and ran a proxy fight on splitting up the company, settling for two seats days before the annual meeting.

"The challenge for companies is that activists often demand, despite their press releases, more than simply a strategic review – they actually want companies to proactively reach out to third parties," Novak told Activist Insight. "That's different. It's not a strategic review, you're putting up the 'for sale' sign."

Indeed, the London-based banker said it was "M&A 101" that "a public announcement may not be the value-maximizing path even if you want to sell yourself."

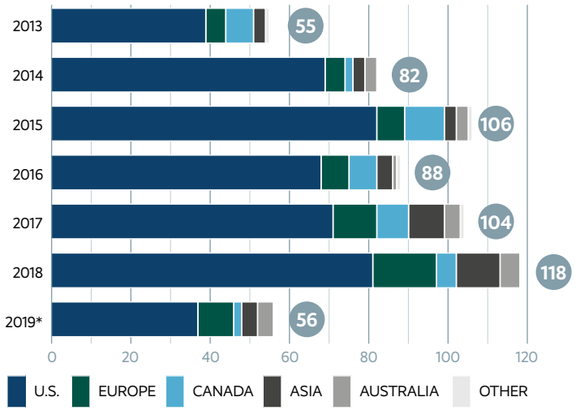
Such a strategy can backfire, even for the activist. At Cars.com, shares tumbled after it said it was unable to find a buyer. Starboard, which had prompted the review and argued the company should improve its performance or sell itself, bailed out of the stock in the aftermath.

### PRO M&A TARGETS BY MARKET CAP



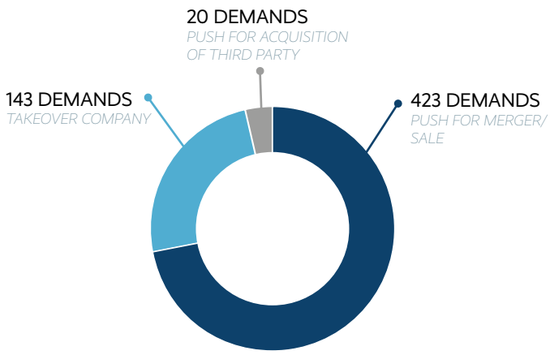

MARKET CAP BREAKDOWN OF COMPANIES PUBLICLY SUBJECTED TO PRO-M&A-RELATED ACTIVIST DEMANDS GLOBALLY SINCE 2013. ROUNDING MAY LEAD TO SUMMATION ERRORS.
SOURCE: ACTIVIST INSIGHT ONLINE

### PRO M&A TARGETS BY GEOGRAPHY




NUMBER OF COMPANIES PUBLICLY SUBJECTED TO PRO-M&A-RELATED ACTIVIST DEMANDS BY YEAR AND COMPANY HQ. *2019 AS OF JUNE 30, 2019.
SOURCE: ACTIVIST INSIGHT ONLINE

### PRO M&A DEMANDS BY TYPE




BREAKDOWN OF PRO-M&A-RELATED ACTIVIST DEMANDS MADE AGAINST COMPANIES GLOBALLY BY DEMAND TYPE FROM 2013 TO JUNE 30, 2019.
SOURCE: ACTIVIST INSIGHT ONLINE

# BARBARIANS NO MORE

As M&A activity has increased in recent years, new patterns have been forming between private equity firms and activist investors, writes Eleanor O'Donnell.

A convergence between activism and private equity has long been predicted on the grounds that activists push up the price of potential private equity targets, while private equity hogs the potential value creation at cheap, underperforming companies for itself. To survive, the two may need to ape each other.

"The view was that activism would tail off a bit because there are only so many public companies," noted Christopher Ludwig, Credit Suisse's head of strategic shareholder advisory. "What we've seen is two-fold: larger well-capitalized activists, the Third Points and the Starboards of the world, are now taking a longer-term, operational view. Two: they can team up with private equity or have their own private equity arms, like Elliott Management."

> "Whereas activist hedge funds often have quarterly or even monthly liquidity; tying up substantial capital in buyout would be problematic if there are significant redemptions."

## Friends or foes?

To start with, activists have preferred to partner up with established firms to help with a takeover. Elliott coupled with Veritas Capital last year to acquire athenahealth, after a long sale process. In June 2018, athenahealth initiated a strategic review and received interest from multiple private equity firms. Elliott came out on top with Veritas, however, and reached a $5.7 billion agreement to take over the company.

> "The convergence between the two is hard to ignore, especially with more activists raising multiyear money, particularly in co-investment vehicles."

The two types of firms are still mostly differentiated by the length of their capital. "[Limited partner] agreements of P.E. funds often do not allow hostile transactions, proxy fights, or short-term investments and can have limitations on taking positions in public companies except for the purpose of gaining control," explained Ludwig. "Whereas activist hedge funds often have quarterly or even monthly liquidity; tying up substantial capital in buyout would be problematic if there are significant redemptions."

Still, the convergence between the two is hard to ignore, especially with more activists raising multiyear money, particularly in co-investment vehicles.

## Buyers of first resort

Indeed, some activist investors seem to be taking the route of buying companies whole instead of pushing for changes publicly. 2018 saw a 44% increase in takeover demands by hedge funds – from nine in 2017 to 12. As of June 30, 2019, 12 takeover demands had been made for the year by hedge funds. The most prominent example of this change is Elliott Management.

In 2017, Elliott disclosed a 15.3% stake in U.S.-based data firm Gigamon and announced its intention to encourage a strategic review. After Gigamon agreed, the activist's private equity arm Evergreen Coast Capital Partners submitted a bid to acquire the company. There were initial disagreements over price but the two reached an agreement in which Elliott acquired Gigamon for $1.6 billion in December that year.

More recently, however, Elliott seems to be taking a different approach. With no prior stake in the firm or attempts to make changes while Barnes & Noble was a public company, Elliott made a $6.50 per share cash bid to take the bookseller private at a valuation of about $683 million, including debt, and the deal was completed in August this year. Attempts by other activists to halt the deal or increase the price fell by the wayside.

## PIPE dreams

While Elliott continues to buy companies outright in a direct private equity strategy, Starboard Value turned to a private investment in public equity, often called PIPE deals, this year. After pizza delivery giant Papa John's International struggled to find a buyer, it turned to Starboard for an infusion of cash and help in both its operational turnaround and defusing conflict between the then-CEO Steve Ritchie, and its founder, John Schnatter and gave the activist board seats in return.

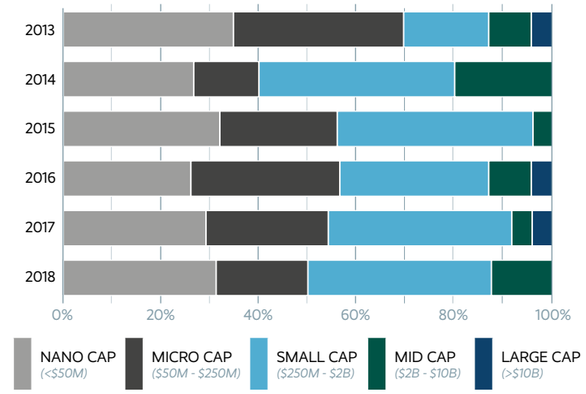
While the arrangement can work, Moelis & Co. Managing Director Craig Wadler told Activist Insight that he does not see it catching on as a trend. "It's always a possibility, but I don't think companies are inviting activists into their boardrooms and share registers all that often. It'll be fewer and farther between," he said.

## Activist private equity

While activist investors have increasingly pushed M&A-related demands at companies worldwide, there has also been an increase in takeover demands from private equity firms that take a stake before making a public offer. Activist-style takeover demands from private equity firms more than doubled between 2017 and 2018, albeit from a small base.

One private equity shop that has taken a more activist approach is Sycamore Partners. After successfully disrupting a rival bid for stationery retailer Essendant in 2018, it sought a year later to acquire Chico's FAS. Sycamore took a 6.6% stake in the women's apparel retailer in May, chiding the board for refusing to engage in takeover talks, while simultaneously reducing its bid to below the company's market price. Privet Fund Management, a hedge fund with an activist bent, repeated the trick last month. Both efforts were rebuffed.

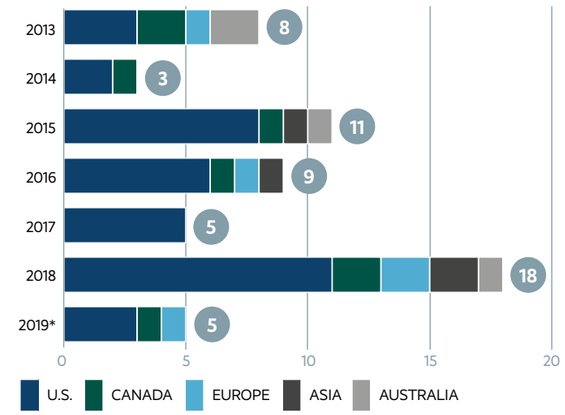
## ACTIVIST TAKEOVER TARGETS BY MARKET CAP




MARKET CAP BREAKDOWN OF COMPANIES PUBLICLY SUBJECTED TO ACTIVIST TAKEOVER BIDS GLOBALLY BY YEAR.

SOURCE: ACTIVIST INSIGHT ONLINE

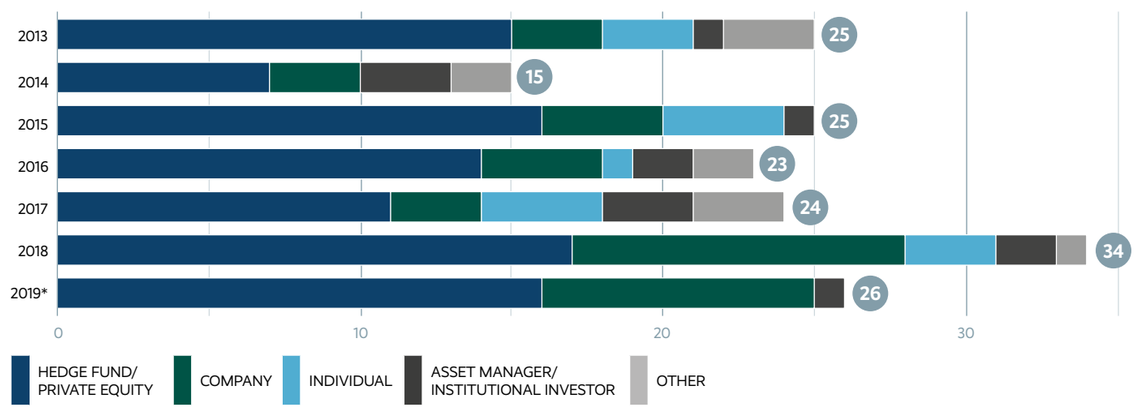
## PRIVATE EQUITY TARGETS BY GEOGRAPHY




NUMBER OF COMPANIES PUBLICLY SUBJECTED TO M&A-RELATED ACTIVIST DEMANDS BY PRIVATE EQUITY FIRMS BY YEAR AND COMPANY HQ. *2019 AS OF JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT ONLINE

## ACTIVIST TAKEOVER OFFERS BY FIRM TYPE




PUBLIC ACTIVIST TAKEOVER DEMANDS GLOBALLY BY INVESTMENT FIRM TYPE AND YEAR. *2019 AS OF JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT ONLINE

# DEAL DEFENSE 101

A company's best defense for or against a deal is to communicate frequently with its shareholders – even before an activist advances a demand, writes Elana Duré.

Proactive preparation and open communication are key elements in defending against activist agitation for or against a deal, investment bankers focused on advising companies told Activist Insight for this report. The bankers indicated that boards should anticipate that an activist will at some point target their firms, questioning the robustness or logic of the company's strategic planning.

"Our advice now is, 'Be ready,'" Jim Rossman, Lazard's head of shareholder advisory, said. "Nine cases out of 10, someone is going to be unhappy and they're going to be willing to go public with that. So prepare."

Preparation involves role-playing and digging through each aspect of the review process to determine what an activist might find problematic and how a board can defend its decision.

"Advanced preparation is key," said Christopher Ludwig, head of strategic shareholder advisory & M&A at Credit Suisse. "You need to be able to counterbalance all the claims that could be made against you and do not want to be caught on the back foot with your board and shareholders when an activist calls."

"Thinking through the strategic merits of the deal, making sure there has been fulsome debate at the board level. You want to be able to justify and defend that deal. Anything that has been problematic from the price to the process is relevant," added Alfredo Poretti, Greenhill's head of shareholder advisory.

"You need to be able to counterbalance all the claims that could be made against you and do not want to be caught on the back foot with your board and shareholders when an activist calls."

## Communication is key

"The area where we spend the most time helping companies is getting the announcement right," Peter Michelsen, Goldman Sachs' head of activism and shareholder advisory for the Americas, told Activist Insight. "You lose an opportunity to tell that story if you don't get it out initially."

Even before a deal is announced, a company should regularly communicate its strategy with shareholders so that there are no surprises once it decides to sell itself or make acquisitions. At announcement, the industrial logic and strategic rationale of the transaction should be communicated. Moreover, management must prove that the price is right.

"You need to make sure the shareholders understand the merits of the deal," Craig Wadler, a managing director at Moelis & Co., told Activist Insight. "Ultimately, you want shareholders to have faith in management and the board that they can create shareholder value."

Bristol-Myers Squibb successfully defended its deal with Celgene after Starboard Value and Wellington Management came out in opposition in February. Institutional Shareholder Services praised Bristol-Myers' explanation of the transaction, saying the deal had "sound strategic rationale." Bristol-Myers said the combined company would be better positioned for long-term growth, predicted the deal would provide a large upfront boost to earnings, and promised it would strengthen innovation.

"The area where we spend the most time helping companies is getting the announcement right. You lose an opportunity to tell that story if you don't get it out initially."

## Unusual play

More drastic defense measures, such as poison pills, are less common. Only nine Russell 3000 companies adopted poison pills so far this year, while five companies terminated their shareholder rights plans early, according to *Activist Insight Governance*.

In the Netherlands, companies may use a stichting, which literally translates to foundation, as a takeover defense. AkzoNobel used its stichting in 2017 to fend off hostile bidder PPG Industries, despite Elliott Management pushing for a sale.

Faced with a controlling shareholder pushing for a merger in 2018, CBS resorted to an even rarer tactic. The board proposed a special stock dividend that would dilute the voting power of Shari Redstone's National Amusements from 79% to 17%, all in an effort to prevent her from forcing it to merge with Viacom, which National Amusements also controlled. The two sides later settled, with National Amusements saying it would not propose a merger for at least two years, although a transaction was announced anyway within 12 months of the settlement.

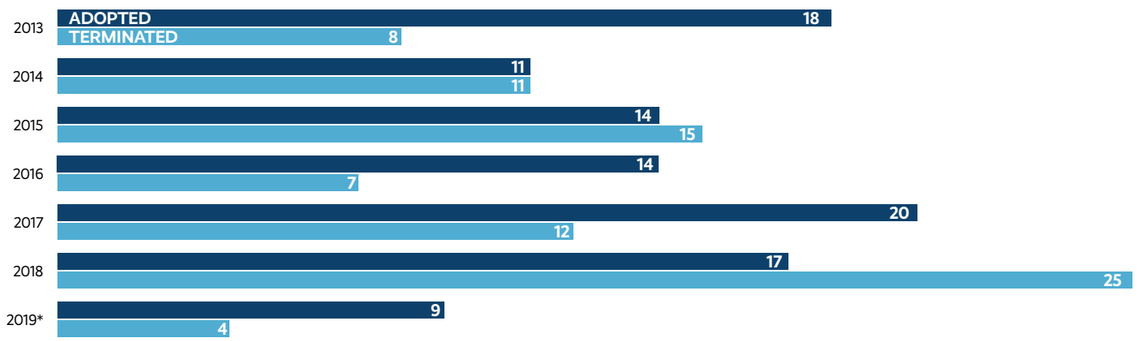
Although uncommon, a company can also engineer a deal to avoid a shareholder vote. Occidental Petroleum in May structured its takeover of Anadarko Petroleum to avoid a vote by issuing preferred shares to Warren Buffett's Berkshire Hathaway instead of common stock.

"Occidental's pursuit of Anadarko has been an impressive display of persistence and creativity," Institutional Shareholder Services wrote in a special situations research report. "As is often the case with determined competitors, Occidental has stepped on some toes along the way; unfortunately, some of these toes seem to belong to its own shareholders."

"As is often the case with determined competitors, Occidental has stepped on some toes along the way; unfortunately, some of these toes seem to belong to its own shareholders."

The deal went through, albeit not without an outraged Carl Icahn lambasting CEO Vicki Hollub's alleged lack of M&A experience and nominating four directors to "oversee future extraordinary transactions." Time will tell if defending the deal merely created new vulnerabilities.

### ADOPTED AND TERMINATED POISON PILLS




NUMBER OF POISON PILLS ADOPTED AND TERMINATED EARLY PER YEAR AT RUSSELL 3000 COMPANIES BY YEAR. *2019 AS OF JUNE 30, 2019.

SOURCE: ACTIVIST INSIGHT GOVERNANCE

### SELECT M&A CAMPAIGNS WITH RELATED PROXY FIGHTS

| YEAR | ACTIVIST | COMPANY | M&A DEMAND | OUTCOME |
|---|---|---|---|---|
| 2019 | CARL ICAHN | OCCIDENTAL PETROLEUM | OPPOSE ACQUISITION OF ANADARKO PETROLEUM | DEAL COMPLETED, CONSENT SOLICITATION ONGOING |
| 2019 | STARBOARD VALUE | BRISTOL-MYERS SQUIBB | OPPOSE ACQUISITION OF CELGENE | ACTIVIST WITHDREW SOLICITATION, DEAL COMPLETED |
| 2019 | MNG ENTERPRISES | GANNETT | TAKEOVER COMPANY | ACTIVIST LOST PROXY FIGHT, RIVAL BIDDER ACQUIRING GANNETT |
| 2018 | BOW STREET | MACK-CALI REALTY | TAKEOVER COMPANY | ACTIVIST WON PROXY FIGHT, NO DEAL AGREED |
| 2018 | PEBBLEBROOK HOTEL TRUST | LASALLE HOTEL PROPERTIES | TAKEOVER COMPANY; OPPOSE TAKEOVER BY BLACKSTONE | ACTIVIST STRUCK DEAL BEFORE SHAREHOLDER MEETING |

SOURCE: ACTIVIST INSIGHT ONLINE