JULY 2020

SHAREHOLDER ACTIVISM IN THE UK

Activist Insight

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July 2020

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Foreword

Activism in the U.K. has been cut in half by COVID-19, but the right conditions are in place for a resurgence, writes Josh Black.

Activist investing in the U.K. has been getting into its stride these last few years. The number of companies publicly subjected to activist demands hit record levels in 2018 and 2019. Special meeting requisitions for board representation trended above the average for the past three years. U.S. activists publicly targeted a record number of companies in 2018 and continued to be a vociferous presence throughout 2019.

Of course, that has largely ground to a halt with the impact of COVID-19. As companies rushed to protect their employees and customers and indefinite lockdowns caused financial projections to be thrown out of the window, activist investors retreated. The number of companies publicly targeted by activists fell from 32 in the first five months of 2019 to 14 in the same period in 2020.

Whether activists decided to sit this proxy season out because of this flexibility or because they were preoccupied with protecting their own staff and portfolios, there is no reason that activist campaigns cannot resume next year, and most bankers expect them to. The pound is still cheap against the dollar, the FTSE 100 is trading at late 1990s levels, and some distressed companies may need rescuing. The favored campaign strategy of recent times, asking U.K. companies to sell overseas assets or relist on more closely followed stock exchanges, could be just as applicable whether businesses get back on their feet or not.

This report, which Activist Insight is proud to publish in association with Latham & Watkins and Georgeson, highlights the variety of activism in the U.K., from large-cap U.S. activists to increasingly creative small-cap agitators, and from the impact of corporate governance to that of political stability. It also highlights a boom in activist short selling, by investors betting against stocks, that we make clear is not just a response to the pandemic.

"Whether activists decided to sit this proxy season out because of this flexibility or because they were preoccupied with protecting their own staff and portfolios, there is no reason that activist campaigns cannot resume next year, and most bankers expect them to."

Ironically, U.K. companies were in some ways more vulnerable to activism in this situation than their international peers. Closely-held European companies with interventionist government supporters have received more attention in recent years but remain a challenge for activists when push comes to shove. U.S. companies benefit from shareholder proposal deadlines that mean board campaigns must start months earlier.

U.K. companies, by contrast, must allow a shareholder vote called by any 5% shareholder within weeks and face a deep bench of activists – foreign and domestic – up and down the market-cap ladder. Perhaps for that reason, the U.K. usually experiences proportionately more activism than other countries in the second half of the year, if not as much as during the traditional "proxy season."

All data are drawn from Activist Insight's suite of databases and news services, which we invite you to trial. As well as longform analysis of trends in shareholder engagement around the world, we track live campaigns and offer a magazine, podcast, and dedicated support team. Please don't hesitate to get in touch if you have questions. ■

Josh Black
Editor-in-Chief
Activist Insight

What's behind the rise and fall of UK activism?

Recent years have seen a major uptick in shareholder activism in the U.K. But some of the key turning points might surprise you, writes Josh Black.

The number of companies publicly subjected to activist demands shot up rapidly – 40% versus the previous year in fact – to a new record level in 2016, the year of the Brexit referendum. In 2018 and 2019, the volume was higher still.

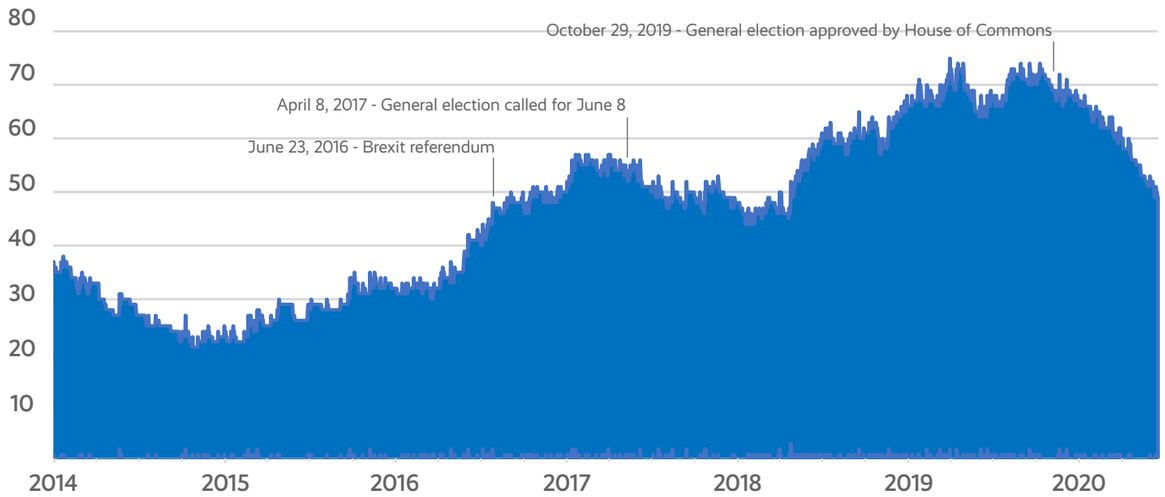
One might assume that the definitive factor was the referendum itself, which depressed the value of sterling and set both the FTSE 100, an index of the U.K.'s largest listed companies, and its smaller sibling the FTSE 250 on an upward trajectory. However, a rolling 365-day total of activist campaigns (see below) suggests that activity had begun to pick up before the referendum, even if it accelerated afterward.

A likely culprit for activism's poor showings in 2017 and 2020 – at least until the coronavirus pandemic roiled stock markets and shut down economic activity – was political instability. The former year featured a general election which sent the country back to a minority government after only two years of Conservative majority rule, while activity began to dip in October 2019, around the time that Boris Johnson began to agitate for a new general election that would lead to an expectation of a harder Brexit.

However, activism at U.K. companies with a market capitalization of more than $10 billion (8.6 billion pounds) was elevated through 2019. Such companies, many of them more exposed to international markets than the U.K.'s, likely supersede such instability.

Naturally, the COVID-19 pandemic has seen a prolonged slide in activist campaigns – as evidenced to the right of the below chart. Whether they return to their previous highs is the key question. ■

365-day rolling total of UK activist campaigns



365-day rolling total of public activist campaigns at U.K.-based companies since 2014. *Source: Activist Insight Online*

Activism in the UK: a timeline

Various forms of shareholder activism have been familiar in the U.K. market for a long time. However, activism has taken off only recently with key legal and economic developments, writes Iuri Struta.

2009

Changes in the 2006 Companies Act give more rights to shareholders. With 5% of the stock, investors can now call special meetings and propose resolutions at annual meetings, among other things. Legal & General's then-CEO Peter Chambers gives public support to Knight Vinke in its campaign at HSBC – a rare move for an institutional investor.

2010

The U.K. adopts the Stewardship Code, guidelines for institutional investors on how to engage with their companies in order to prevent moral hazard, as a consensus forms that shareholders need to hold companies accountable for underperformance. Cadbury, a target of Trian Partners since 2006, is acquired by U.S. company Kraft in an 11.5 billion pound ($18.9 billion) deal that draws criticism from the tabloid press and trade unions.

2012

Professor John Kay releases a review concluding that short-termism is an underlying problem in U.K. equity markets. To restore relationships of trust in the investment chain, Kay proposes the formation of an investors' forum to foster more effective engagement. The Investor Forum is created two years later; its first engagements are with Standard Chartered, Tate & Lyle, Rolls-Royce Holdings, and Sports Direct.

2015

ValueAct Capital Partners invests in Rolls-Royce Holdings and the following year one of its partners joins the board, following a behind-the-scenes engagement. Elliott Management launches a proxy contest at Dundee-based asset manager Alliance Trust and reaches a last-minute settlement that later leads to the departure of both the chair and CEO.

2018

The Investor Forum is a major player as British-Dutch consumer giant Unilever shelves plans to relocate its headquarters to the Netherlands, acting on behalf of 20 institutions. Fifty-five U.K.-based companies are publicly subjected to activist demands, breaking the previous record of 42 in 2016.

2019

The U.K. overtakes Canada to become the fourth-busiest market for activism in the world after the U.S., Australia, and Japan.

2020

The year starts off with household name U.S. activists ValueAct, Elliott, Trian, Third Point Partners, and Sherborne Investors (as well as SpringOwl Asset Management and Coast Capital) all invested in the U.K. However, COVID-19 leads to a decline in the number of new campaigns and Sherborne withdraws a withhold campaign at Barclays in recognition of the crisis. ■

How boards can prepare for post-crisis activism

By Richard Butterwick, an M&A Partner in the London office of Latham & Watkins, and a former global co-chair of the firm's Public Company Representation practice.

U.K. public companies have been frequently in the crosshairs of activist shareholders in recent years as uncertainty around Brexit and related currency fluctuations created opportunities to target U.K. businesses. At the time of writing, we are starting to see the green shoots of those activist activities break out publicly, including Cevian Capital's recently announced investment in Pearson.

In a post-COVID environment, strategies for new campaigns are likely to include pressuring listed companies towards public-to-private transactions, carve-out and IPO spin offs, credit investment pressure including loan-to-own restructuring, and structural/operational change to address COVID-related industry impacts. Activists may also advocate changes to management personnel where companies are seen to have underperformed their peers in responding to the pandemic.

There are a number of steps that boards of U.K. listed companies can take now, whether they are strengthening their defences against activists or preparing for constructive engagement with potential new investors.

> *"We expect companies in the life sciences sector that have recently undertaken business combinations to be closely watched by investors promised material non-core divestiture strategies and closely aligned portfolios."*
> **Robbie McLaren**, partner – Life Sciences and Tech M&A

1. Communicate regularly with the market: Given the uncertain economic conditions, it is important for management to continue to explain openly to investors and other stakeholders the impact COVID-19 related restrictions and market change is having on the business, its supply chain, customer base etc., as well as the steps being taken to address these issues, which for some industries are clearly causing systemic shock and a rebalancing of business risk to many others.

> *"The insurance sector has seen its fair share of activist activity in recent years, and we can expect investors to continue to scrutinize board strategy closely to maximise returns on capital deployment."*
> **Victoria Sander**, partner – Financial Services M&A

2. Engage with the company's shareholders: Companies should regularly review their registers in detail, with analysis of prime-broker, stock-borrow, and notable custodian positions being a sign of potential activist positioning. Many companies will pro-actively seek to understand their share register by issuing beneficial ownership requests under s.793 of the Companies Act on a regular basis – giving access to information not otherwise available in the public disclosures.

> *"The lines that have traditionally marked out investors are continuing to blur. This is true of activist investors and private equity funds, many of whom are developing complimentary strategies. Take-private deals are a natural next step of activist funds implementing control positions in the UK."*
> **Farah O'Brien**, partner – Private Equity & M&A

3. Consider strategic alternatives and associated financial implications: Reviewing the company's strategic options at a time of significant disruption in many industries is an important step in assessing the likelihood of an unsolicited offer or activist campaign against management. It will also provide the board with a firm foundation for responding to any approach from activists or negotiating with potential new investors.

> *"In many situations, the best form of board defence is positive engagement - constructive engagement with investors in times of market dislocation is critical."*
> **Nick Cline**, partner – M&A & corporate

4. Assess the company's performance in relation to environmental, social, and governance (ESG) matters: Activists are increasingly targeting companies with a poor record on ESG matters. The increased focus on ESG by institutional investors, as well as the prominent use of proxy shareholder services such as Institutional Shareholder Services (ISS) and Glass Lewis, have helped activist funds orchestrate successful campaigns around these themes. The board should assess, with professional advisers, whether there is scope for improvement and if so take action now.

> *"There is a reshaping of the energy sector occurring that has created a market environment expecting bold strategic decisions to be taken. We anticipate activist investors will be a voice for change in many companies in the sector."*
> **Sam Newhouse**, partner – M&A & corporate

5. Plan how the company will react to any approach: After longer term assessment, active investors will often move quickly following initial private correspondence to the board, so the board should prepare in advance how it will counter an approach. Management should have a clear sense of its key messages to support its current strategy and how this will create long-term shareholder value.

A final word should go to Brexit, and the impending changes on the corporate landscape it will carry. At the time of writing, no extension to the transition period for the U.K. is envisaged, and the U.K. will leave the EU with or without a trade deal at the end of the year. The confluence of changing market dynamics post-health crisis with the uncertainty and business impact Brexit imposes on existing strategic plans, means this is likely to give rise to activist investor focus and be fertile ground for activist campaigns in the year to follow. ■

Connor Cahalane, Knowledge Management Counsel, assisted with the preparation of this report.

Under the radar

Although large-cap campaigns dominate the news cycle, the U.K. has the most vibrant market in small-cap activism in Europe. Amid myriad threats, activists see cause for optimism, writes Josh Black.

For a country that breaks its stock market into three benchmark indices with a narrow elite, it's no surprise that smaller issuers are starved of attention. The same is arguably true of its activists.

Although the roughly 200 companies with a market capitalization above $2 billion (1.58 billion pounds) have seen an elevated number of activist campaigns since 2015, the U.K.'s more than 1,000 smaller companies have become an increasingly important part of the activist universe.

Forty-five small-to-nano-cap companies were publicly subjected to activist demands in 2019 – a record. The total was 82% of the year's activist targets – the highest proportion since 2013, when fewer than half as many activist campaigns were launched.

Local stalwarts – including Christopher Mills' Harwood Capital, Richard Bernstein's Crystal Amber, and Martin Hughes' Toscafund Asset Management – are not as high profile as they once were. Now, the cast of characters is more diverse and a range of tactics, from proxy fights by ex-executives like Julian Dunkerton at Superdry, to special dividend proposals like the one at liquor producer Stock Spirits earlier this year, show dissidents are getting creative.

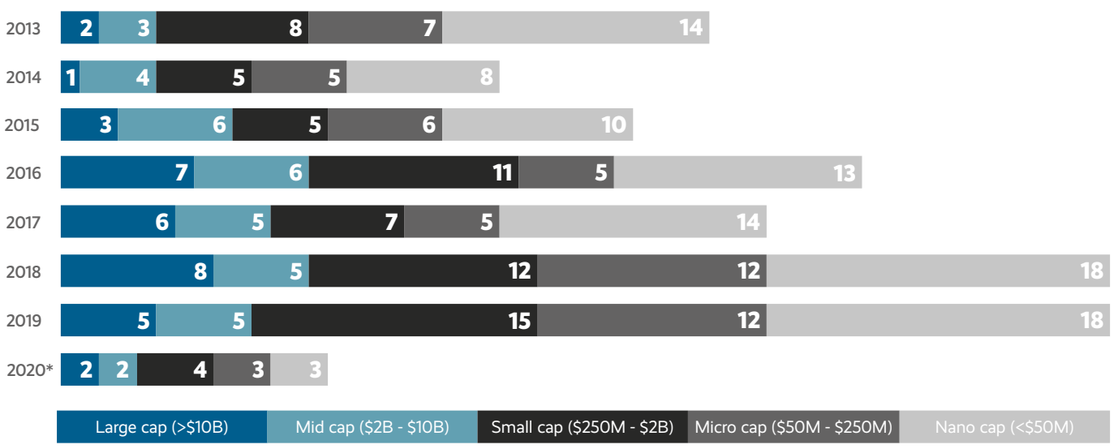
Room for optimism

With more campaigns in Continental Europe focused on large-cap companies, the U.K. has been an outlet for investors looking to escape the high valuations that have become commonplace amid the U.S.' historic bull market. Smaller firms may be the most vulnerable to squeezed profit margins caused by COVID-19 or Brexit regulation; they may also be nimbler and less exposed to international markets - allowing for a faster recovery.

Investors are certainly confident. Unlike the U.S., where larger companies have long outperformed, British small caps have often bettered their larger peers. At the end of May, the London AIM Index, which tracks smaller companies, was down just 8% year-to-date, compared with 19% and 21% for the FTSE 100 and FTSE 250, respectively.

And while the City of London may once have been a clubby haven, American activists racked up some notable successes last year, including a board seat for Browning West founder Usman Nabi at the U.K. arm of Domino's Pizza shortly before the company selected a new chairman, and a consultation on new directors at Playtech for Jason Ader's SpringOwl Asset Management.

UK activist targets by market cap and year



Number of U.K.-based companies publicly subjected to activist demands by year and market cap. *2020 data as of May 31, 2020.

Source: Activist Insight Online

> *"I was warned by a friend that the U.K. can be a challenging market but we hired good advisers, and they suggested that we had good odds of success."*

"I was warned by a friend that the U.K. can be a challenging market but we hired good advisers, and they suggested that we had good odds of success," Nabi told Activist Insight, citing the rule of law and cultural norms as major comforts. "In our mind, it's a country where we would have the most confidence of any country in the world, alongside the U.S. and Canada."

From Gilded Age to the Titanic

In simpler times, Gatemore Capital's Liad Meidar was fond of hailing "the golden age of activism in the U.K."

2020 looks like a more challenging year. Going into the coronavirus pandemic, there had been a focus by activists on M&A and balance sheets – the kinds of demands likely to be the least palatable in the aftermath of the crisis. Only 10 companies with a market cap of less than $2 billion had been publicly subjected to activist demands by the end of May, the lowest for a comparable period since 2014 and one-third of targets at the same point last year.

COVID-19 will have "a deeper and longer-lasting effect than Brexit," Meidar told Activist Insight in an interview in late May. "The first priority of engagement is how we can support the business through this. This is not the time to be rearranging deck chairs on the Titanic," he said.

Meidar was quick to rule out asset sales, saying he expected most M&A would wait until 2021 – although Gatemore had cause for celebration when the U.K. Takeover Panel quashed a pandemic-inspired attempt by Michael Shina to terminate an agreement to acquire suiting store Moss Bros.

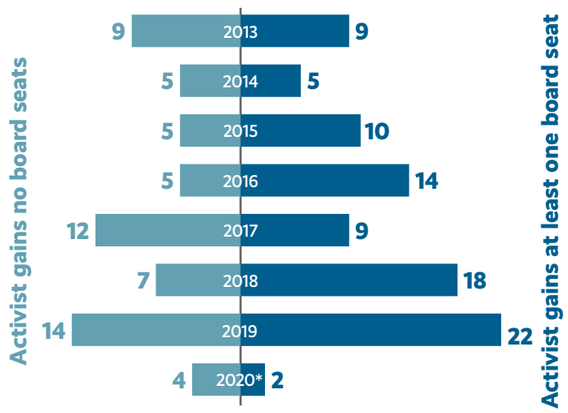
Bouncing back?

A more promising frontier for activists may be growth companies, Meidar predicts. ValueAct Capital Partners already has a board seat at Horizon Discovery Group through its impact-driven Spring Fund, and in March Gatemore took a stake in Sensyne Health, a formerly high-flying health technology firm that has had its share of governance issues and is likely suffering secondary effects from the prolonged shutdown of its largest shareholder, Woodford Investors. Gatemore has yet to make a public demand.

According to Andrew Honnor, whose Greenbrook Communications represents activists, "The smaller ones are slightly more busy at the moment."

"They have a little bit more freedom because they're going to attract less public attention," he explained. "The larger ones are pausing to evaluate how to most effectively operate a public campaign in this environment." ■

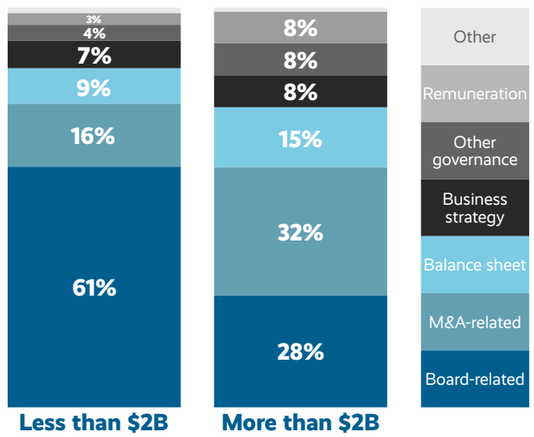
UK board representation demand outcomes



Outcomes of activist demands for board representation, by year. *2020 data as of May 31, 2020.

Source: Activist Insight Online

UK activist demand types by market cap



Breakdown of activist demands made at U.K.-based companies by demand type and market cap in the period January 01, 2013 to May 31, 2020.

Source: Activist Insight Online

The special relationship

"The U.K. offers the types of market inefficiencies and stock mispricing that had largely been rooted out in the U.S."

The U.K. represents one of the most attractive markets in the world for activists including those from overseas. U.S. hedge funds have learnt to navigate its cultural differences, writes Jason Booth.

The number of U.K. companies facing demands from U.S. activists has increased substantially in recent years, with a record high 21 publicly subjected to activist demands in 2018 according to Activist Insight data, and 16 in 2019. In both years, U.S. activists accounted for more than half of U.K. companies that were subjected to demands by foreign activists. By comparison, Continental Europe-based funds publicly targeted four companies in the U.K. last year.

Elliott Management, which has long had an office in London currently headed by Paul Singer's son Gordon, has been by far the most active U.S.-based activist, publicly targeting 13 U.K-based companies since 2013. ValueAct Capital Partners comes second with four companies targeted, while Trian Partners and Sherborne Investors both targeted three. Other notable U.S. funds active in the U.K. market are Third Point Partners, Paulson & Co, and Sachem Head Capital Management.

Like most of the world, activism in the U.K. remains subdued this year, but an early sign that the country remains on the radar of U.S. activists came June 10, when Sachem Head disclosed a 5.3% position in London-based security company G4S. The investment comes roughly two years after the New York-based activist successfully lobbied U.K.-based Whitbread to spin out its Costa Coffee subsidiary.

First choice

For many observers, the U.K. is the obvious choice for U.S. activists looking overseas for new opportunities.

"Outside of the U.S., the U.K. is really the only broad, deep market in the world," said James Rasteh, a partner at New York-based Coast Capital, which since 2018 has been agitating at U.K. transport services company FirstGroup for board changes and to divest its U.S. businesses.

Relatively untouched by activists, the U.K. offers the types of market inefficiencies and stock mispricing that had largely been rooted out in the U.S. It is also a broad, deep market offering a diversity of industries to invest in. For example, Elliott Management's five current active U.K. positions include companies in the insurance, restaurants, medical devices, semiconductors, and grocery stores industries. Other U.K industries popular with U.S. activists are energy, beverages, gambling, and telecommunications.

Equally important is shareholder-friendly governance and the rule of law. "The fact that the government doesn't meddle in investor affairs there is a specific and strong set of laws," Rasteh stated when asked what attracted the fund to the U.K.

Slow start

Yet, U.S.-style activism hasn't always been popular. Trian's multiyear campaign at Cadbury Schweppes, ending in the sale of the beverage and confectionary giant to U.S. company Kraft in 2010, elicited sharp criticism from both the tabloid press and trade unions at a time when the U.K. was recovering from the 2008 financial crisis.

It also got off to a relatively slow start, with an average of less than six U.K. companies publicly subjected to demands by U.S. activists annually between 2014 and 2017. One reason was the risk overhang caused by Brexit. Rasteh, meanwhile, suspected that 2014's so-called "put up or shut up rule" that requires a bidder to make a formal offer for a target within 28 days after its intentions become public, "has made life difficult at the margin for a lot of investors that might be much more engaged otherwise."

But ValueAct's 2015 investment in Rolls-Royce Holdings, resulting in one of its partners joining the board, was seen as a key moment that set the stage for a rise of future campaigns. Since then, a majority of the most successful cases of U.S. funds prompting change at U.K. companies have come via collaborative activism.

"It showed there doesn't necessarily have to be an aggressive, table-thumping, American-style campaign," said James Thomlinson, managing director at Jefferies in London. "There is a way to be extremely effective by doing things on a consensual basis."

Make up to breakup

A recent feature of U.S. demands has been the divestment of North American assets held under British listings. In September, U.K.-based plumbing supplies company Ferguson agreed to break up its business and seek a primary U.S. listing just two months after Trian, taking a far friendlier tone, said it "looked forward" to working with the management "to explore and implement initiatives" to create long-term shareholder value. And in March, British insurance giant Prudential announced plans for an initial public offering for part of its U.S. business weeks after activist Third Point Partners publicly called for the move, saying it hoped to "collaborate" with management.

In the same month, FirstGroup announced it was launching a formal process to sell its U.S.-based operations after discussing the move with Rasteh's Coast Capital and other investors under the auspices of the Investor Forum. Coast Capital had previously lost a proxy contest over the issue, but the company subsequently refreshed its board anyway.

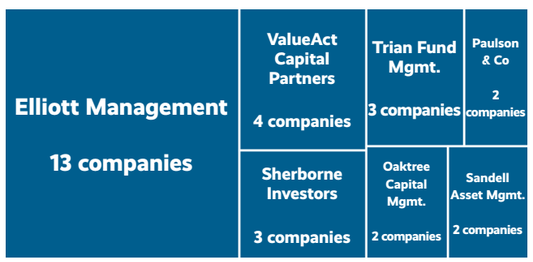
The comeback

Since 2019, there have been signs that U.S. activists might start looking beyond the U.K., to less efficient, less liquid European markets with targets such as German industrial conglomerate ThyssenKrupp, Italy's Telecom Italia, Switzerland's Nestlé, and French eyewear group EssilorLuxottica.

Yet the disruption caused by COVID-19 may actually change that trend. Rasteh worries that in times of economic distress, governments in other European countries are more likely to decide arbitrarily that a company facing activist demands is of "national interest," or that domestic shareholders voting in a proxy contest might decide to support an outcome "that is more politically palatable in the short term" but makes little sense in terms of value creation.

"You might be able to make more money in other European markets, but you have to spend the time and get it right," said Malcolm McKenzie, managing director at Alvarez & Marsal. "But in times of market disruption most activists will go back to the easiest market and it's easier to get it right in the U.K. ■

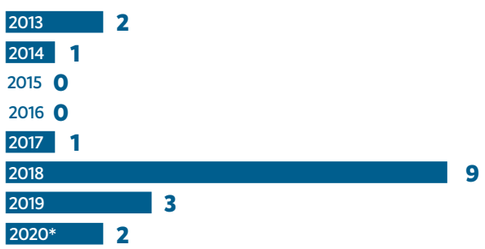
Top US activists in the UK



Top U.S.-headquartered activists (excluding 'engagement focus'), by number of U.K.-based companies publicly subjected to activist demands since 2013. Note: Elliott Management has a London office.

Source: Activist Insight Online.

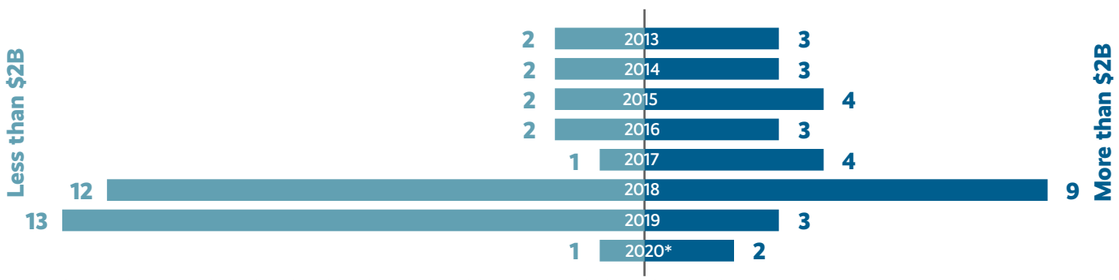
US-led breakup campaigns



Number of U.K.-based companies publicly subjected to sell/retain assets, push for company division or spin off/sale of business division demands by U.S.-based activists. *2020 data as of May 31, 2020.

Source: Activist Insight Online.

US targets in the UK by market cap

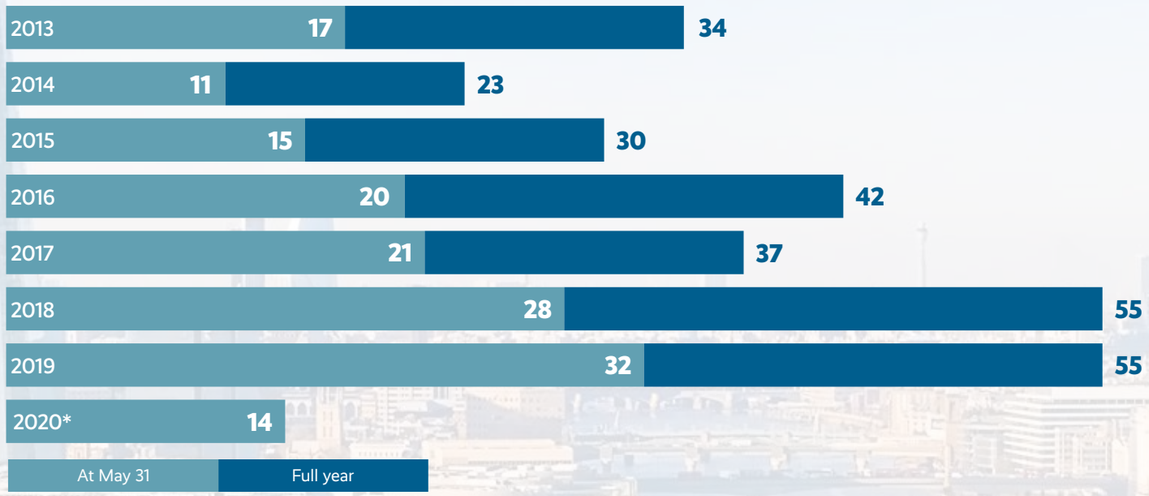


Number of U.K.-based companies publicly subjected to U.S.-based activists' demands by market cap. *2020 data as of May 31, 2020.

Source: Activist Insight Online.

UK activism in numbers

UK activist targets by year



Number of U.K.-based companies publicly subjected to activist demands. *2020 data as of May 31, 2020.

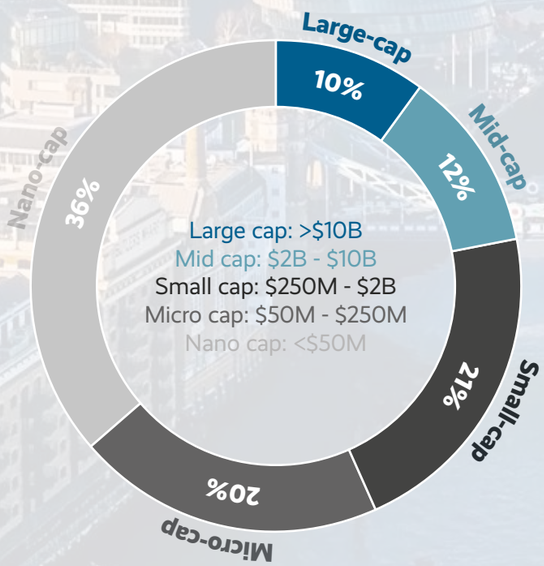
Source: Activist Insight Online.

Selected activist demand types in the UK by year

Number of public activist demands made at U.K.-based companies by demand type and year. *2020 data as of May 31, 2020.

Source: Activist Insight Online.

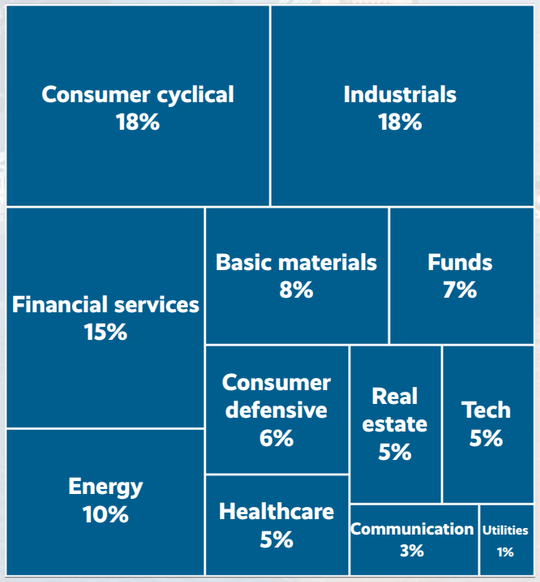
UK activist targets by market cap



Breakdown of U.K.-based companies publicly subjected to activist demands since 2013, by market cap.

Source: Activist Insight Online.

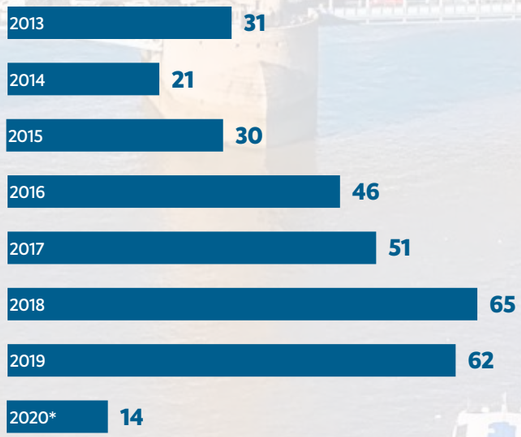
UK activist targets by sector



Breakdown of U.K.-based companies publicly subjected to activist demands since 2013, by sector.

Source: Activist Insight Online.

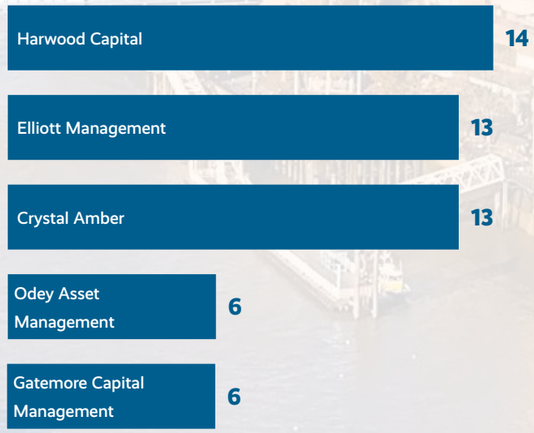
Active activists in the UK



Number of investors making activist demands of U.K.-based companies, by year. *2020 data as of May 31, 2020.

Source: Activist Insight Online.

Top UK activists



Top activist investors by the number of U.K.-based companies publicly subjected to its activist demands since 2013. Data exclude activists with an engagement focus on activism as defined by Activist Insight.

Source: Activist Insight Online.

The City, activism, and COVID-19

Traditional long investors were in no mood to support activists during proxy season but a yearslong warming to their merits may continue, writes Cas Sydorowitz, Global Head of M&A and Activism at Georgeson.

At the start of the COVID-19 pandemic, investors worried about the survival of their portfolio companies at the same time as they were unexpectedly figuring out how to work from home right at the start of the European proxy voting season, when they face the huge task of voting at thousands of meetings. Reviewing proxies, writing reports, and engaging with all of these companies – already a Herculean task – became more difficult still.

Checking your own policies, seeking input from portfolio managers, reading, and considering Institutional Shareholder Services (ISS) and/or Glass Lewis recommendations in the same condensed window is difficult during normal working conditions.

Now is not the time

The practical challenges of speaking to the right contacts and the sensitivity of trying to push for change during the worst global crisis since the Global Financial Crisis of 2008 meant there were fewer activist situations in the U.K. Governance analysts didn't have the capacity to engage with activists trying to push for change in the first half of 2020, especially when many of those demands over time have focused on returning cash through share buybacks or larger dividends. With regulators and investors encouraging or requiring companies to suspend their dividends in order to preserve cash, a push on this front from activist investors would not have been tolerated.

> *"Traditional long investors are showing a greater willingness to engage with activists."*

That doesn't mean that the activists sat idle. Several have taken or increased their stakes, taking advantage of price dislocations in the companies that had been on their radar for a long time. Market conditions and falling share prices allowed many activists to bolster their positions during the period. Trying to run a campaign during the crisis would have projected an image that activists were tone deaf to what was happening around them.

Getting accustomed to the new normal, traditional long investors are showing a greater willingness to engage with activists. They have gotten accustomed to working from home and dealing with the challenges of remote working.

Getting strong now

That is coupled with many activists getting smarter in how they engage with traditional investors. The dialogue is not campaign specific but much broader, allowing activists to establish relationships with the largest investors. Many of the City's institutional investors have engaged with various activists over the last four months about broader governance, as well as environmental and social issues.

Activists have realized that they need to establish long-term relationships with the City's largest investors so that when they run a campaign they are not perceived as ambulance chasers. They are hiring people with a governance background or even from activist defense teams at the largest investment banks.

We have entered a new phase where some investors are identifying problem portfolio companies and seeing whether there is an activist who can make changes on their behalf to unlock value. These co-investment structures allow an activist to gain influence using the holdings of the investors without having to buy so many shares. Activists can leverage the support from these investors who are already disgruntled and willing to commit their shares to an activist campaign. Some institutional investors have created a watch list and are seeking help for these portfolio companies.

When household investors can become the silent supporters and facilitators of activist campaigns, U.K. corporations have every reason to be concerned. ■

Less spats, more chats

"Anyone can come and buy or merge with a U.K. company whenever they want. Having a big campaign about it was kind of missing a trick."

Although more shareholder-friendly than the U.S., governance in the U.K. encourages dialogue at the expense of loud, moralistic campaigns, writes Eleanor O'Donnell.

While U.K. activist campaigns have traditionally resembled those in the U.S., it would be a mistake to assume that corporate governance is the same in both countries. U.K. corporate governance, more uniform and in many ways more shareholder-friendly than in the U.S., has a distinct bearing on how investors operate.

All-year proxy season

Any shareholder with a 5% stake can call a special meeting at any time, meaning activists don't need to launch the kind of costly consent solicitation campaigns sometimes used in the U.S. or wait for a company's annual meeting to force change.

For example, it took just over six weeks between April 2, when easyJet's founder and largest shareholder, Stelios Haji-Ioannou, requisitioned a special meeting to remove non-executive directors in protest at their failure to cancel an order for 107 Airbus aircraft, and May 22, when the meeting was held. Haji-Ioannou lost that vote, though several directors subsequently stepped down.

Last year saw a recent record 22 special meetings requisitioned at U.K. companies for votes on board representation, according to *Activist Insight Online*. Since 2013, the total number of requisitions is 90.

Separation of powers

Another key difference is that very few U.K. companies have one person as both chairman and CEO. Indeed, the U.K. Corporate Governance Code states: "A chief executive should not become chair of the same company." With such different jobs giving one individual a concentrated level of power, investors and companies have acknowledged that it is not good governance to combine the roles, Minerva Analytics CEO Sarah Wilson noted in an interview with Activist Insight.

Indeed, as of June 15, 2020, 98.9% of FTSE 350 companies had the roles separated while only 56.3% of S&P 500 companies had done the same thing. In 2016, Schroders chairman Michael Dobson faced a shareholder revolt when he was elevated from CEO to chairman.

According to Wilson, governance in the U.K. is less litigious and more about relationships – boards are more prepared to talk and listen to shareholders. "A particular strength of the U.K. is the culture of dialogue and principles instead of a legalistic mentality," she said.

A key change in that direction was the establishment of the Investor Forum in 2014 to restore relationships of trust in the investment chain and foster more effective engagement. The Forum played a key role in the talks that led to ValueAct Capital Partners winning a board seat for one of its partners at Rolls-Royce Holdings, the first time an activist had done so at a FTSE 100 company.

Activist investors have also played a very important role in the changing landscape of corporate governance, Wilson added. "You need diversity," she noted. "You need someone pushing the envelope - outsiders coming in and shaking it up – otherwise it can become too complacent."

Different approach

The level of governance in the U.K. has at times raised questions about the need for U.S.-style activist campaigns, which often gain leverage and moral justification by targeting governance failures.

James Thomlinson, managing director at Jefferies in London pointed to Marcato Capital Management's 2014 campaign to push InterContinental Hotels Group to seek a merger. The activist published a lengthy presentation but gained little support among investors and analysts, who saw no reason to doubt management's ability to decide the company's future.

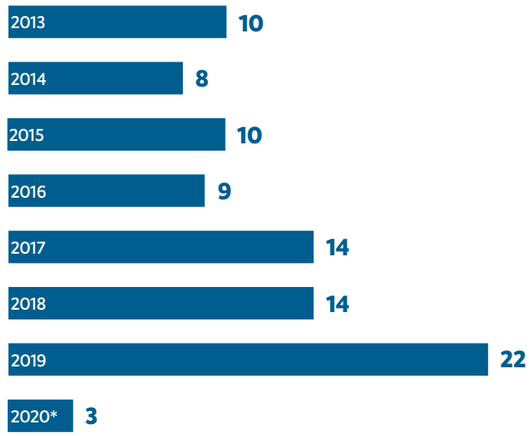
"Everyone in the U.K. kind of shrugged their shoulders," said Thomlinson. "It's not like in the U.S. where there are poison pills and staggered boards. The framework in the UK is such that anyone can theoretically buy a U.K. company whenever they want. Having a big campaign with a 77 page presentation on why they should sell the company was wide of the mark."

Adding E & S

Going forward, companies and activists intending to sit on their boards will also have to focus on relationship building with employees. Recently published updates to the U.K. Corporate Governance Code place stronger emphasis on engagement with the workforce alongside the company's duty to shareholders. To facilitate this, it recommends one or a combination of the following methods: appointing a director from the workforce, creating a formal workforce advisory panel, or designating a non-executive director to represent employee interests.

The economic and social fallout of the COVID-19 pandemic will make considering employees, and other environmental, social, or governance (ESG) issues even more important, according to Alvarez & Marsal Managing Director Malcolm McKenzie. "The scrutiny around how companies are treating their staff amid the crisis will remain high, even after the dust has settled on corona, and links to the responsible capitalism theme," he explained. ■

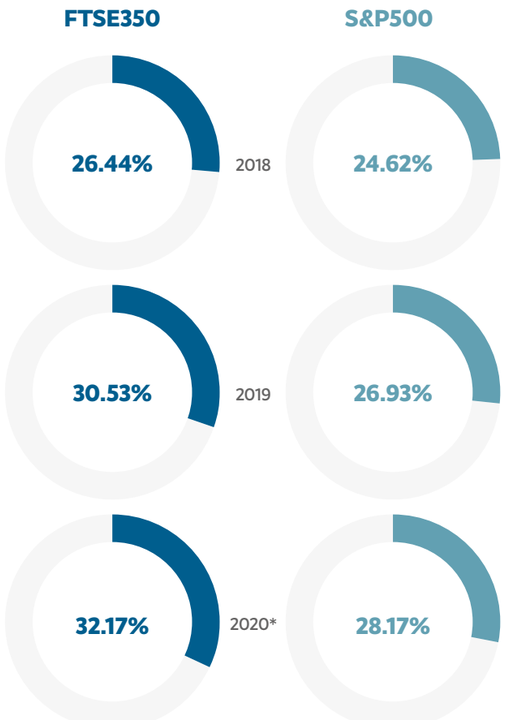
UK meeting requistions for board representation



Number of demands for board representation at U.K.-based companies where a meeting was requisitioned. *2020 data as of May 31, 2020.

Source: Activist Insight Online.

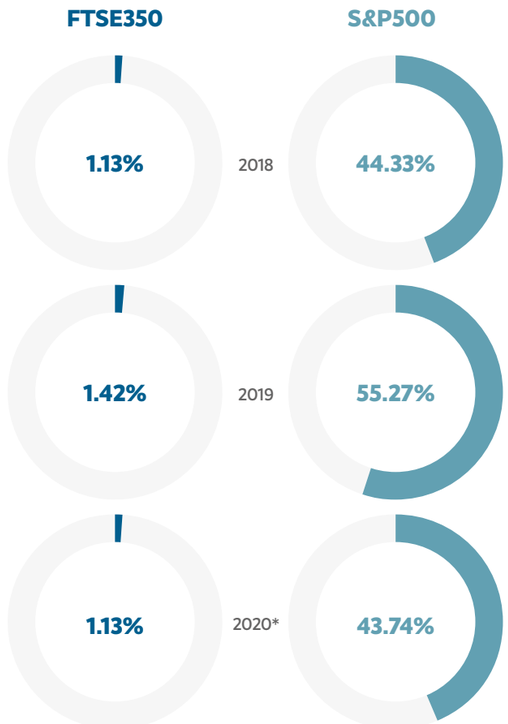
FTSE350 and S&P500 gender diversity



Gender diversity (% of women on boards) of FTSE350 and S&P500 boards by year. *2020 data as of June 15, 2020.

Source: Activist Insight Governance.

FTSE350 and S&P500 combined Chair/CEO



Percentage of FTSE350 and S&P500 companies with a combined CEO and chair by year. *2020 data as of June 15, 2020.

Source: Activist Insight Governance.

Short lessons

While activist short selling in the U.K. remains muted compared to other markets, recent campaigns have highlighted major flaws in the relationship between companies, auditors, and their shareholders, writes John Reetun.

Between the start of the year and May 31, the U.K. saw six separate short campaigns launched against U.K.-headquartered companies, the highest for comparable periods since 2013.

Despite the jump, rising from a single campaign in 2019, the U.K. is a far cry from becoming a hotspot for activist short sellers like the U.S. and China. However, some campaigns have highlighted major flaws in the relationship between companies, auditors, and their shareholders.

London calling

Regardless of the relatively low number of yearly campaigns, Muddy Waters Research's Carson Block said that the U.K. "is actually one of the markets we view most favourably when it comes to what we do as a short seller." He added that the space shows a "healthy appreciation for activists like ourselves and that we are doing good for the market in outing bad company behaviour."

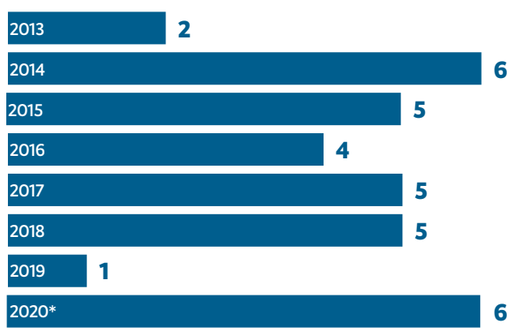
Indeed, while France and Germany have cracked down on activist short sellers, the U.K. has not introduced any punitive policies other than those that are uniform across the European Union. Company disclosures are just one aspect of what has made the U.K. attractive to activist short sellers in recent years, the other being the big game on offer in the market.

Matthew Wiechert, whose Bonitas Research launched its first campaign in the U.K. with Pets at Home Group this year, plans to continue looking for new ideas in the U.K., noting that the "level of disclosure available for U.K. companies" makes it a worthwhile endeavor.

No recent campaign better encapsulates the opportunity than the accounting scandal at NMC Health. The Abu Dhabi-based healthcare provider was targeted by Muddy Waters in December 2019, saying the firm had "manipulated" its balance sheet. NMC responded soon after that its financials were "solid." However, an internal investigation into stakes held by founder and former chairman BR Shetty, along with two other partners, ultimately forced Shetty to resign in February.

Following Shetty's departure, NMC formed a special committee to investigate the company's debt, leading to the uncovering of $4.5 billion of previously undisclosed debt by March 24. The London Stock Exchange initially suspended NMC's stock from being traded in late February. The firm was eventually delisted in April, by which time Muddy Waters had amassed a hefty 46.3% campaign return.

Activist short campaigns in the UK



Number of activist short campaigns launched against U.K.-based companies, by year. *2020 data as of May 31, 2020.

Source: Activist Insight Shorts.

> ***"Auditors and investment banks are incentivized to complete deals and submit filing checklists, not to flag irregularities."***

Open invitation

"What we were surprised about since issuing our report in December last year was how massive the fraud was," Carson Block told Activist Insight for this report. The short seller noted that while he "knew NMC was a fraud with a whole host of issues," the events that proceeded the report, were "remarkable."

The fallout at NMC proved enough of an invitation for other short sellers to explore the U.K. for the first time. Bonitas' founder Matthew Wiechert told Activist Insight that it was after Muddy Waters' success with NMC that he started to "pay attention to U.K.-listed companies," eventually releasing a report against U.K. retailer Pets at Home Group.

The report alleges Pets at Home kept a joint venture alive through a series of undisclosed loans, an act that Bonitas said will see the company's stock plummet as much as 75%. Asked how a company can hide such a supposedly fragile financial state from its investors and regulators, Weichert noted that "often it's the same answer: debt and undisclosed related party dealings."

A little too cozy?

Weichert added that while governance standards in the U.K. provide decent levels of disclosure, regulators remain at a disadvantage. "The issue remains a lack of resources, primarily time and headcount relative to the number of companies and their agents," adding that "auditors and investment banks are incentivised to complete deals and submit filing checklists, not to flag irregularities," leaving an apparent disconnect in the checks and balances of a company.

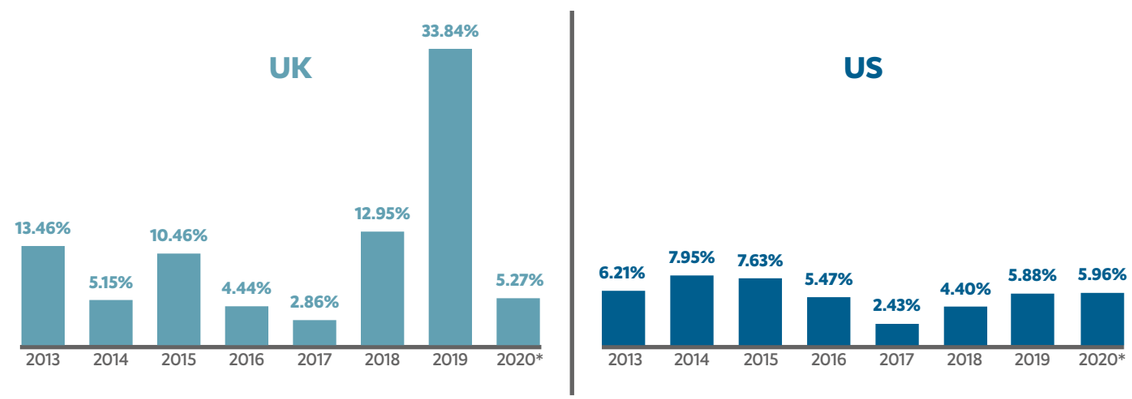
Muddy Waters made similar claims against NMC, suggesting the firm's "cozy" relationship with auditor Ernst & Young led to less rigorous audits. Ernst & Young declined to comment.

Before NMC's delisting, the Financial Reporting Council (FRC) confirmed it was investigating NMC's 2018 audit from Ernst & Young. While the auditor did not comment on allegations about its role, stating, "It is not our policy to comment on the companies we audit," it said it would be "fully cooperating" with the FRC's investigation. Each of the other "Big Four" audit firms declined to comment on criticism by activist short sellers.

Block said while U.K. corporate governance is among the best in the world, the "bar is unfortunately quite low." He added that "investors need to heed the warning that just because a company is listed in the London Stock Exchange, with so-called 'blue chip' banks and auditors advising them, this doesn't mean it is above board."

Meanwhile, Wiechert suggested U.K. regulators should consider "harsher punishments on the gatekeepers for facilitating frauds that list and raise capital from unsuspecting minority investors." ■

Average one-week returns of activist short campaigns at UK and US companies



Average one-week campaign returns of activist short campaigns launched against U.K- and U.S.-based companies by year. *2020 data as of May 31, 2020.

Source: Activist Insight Shorts.