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Podcast transcript - Shareholder Activism - Trends and tips for the Year Ahead

Filippo de Falco:	Hello and welcome to today's Slaughter and May podcast on shareholder activism. I'm Filippo de Falco, a Partner in the Corporate team here at Slaughter and May.
Claire Jackson:	And I'm Claire Jackson, also a Partner in the Corporate team.
Filippo de Falco:	In today's podcast we'll be looking at activism trends that emerged over the course of 2020, and will do some horizon scanning to consider whether some of these trends are going to continue over into 2021. We'll end with some tips for companies who are seeking to defend themselves against activist shareholders. So let's start, Claire. 2020 was clearly a rollercoaster year on many fronts; politics, public health, sports, you name it. Was that true for activism?
Claire Jackson:	Yes, and probably the understatement of the year, that it was definitely quite a year! By activism terms, from the outset of 2020, it looked as though we were in for another year of record levels of activism, and that was building on the lofty heights of 2018 and 2019 too. In January and February, we saw a surge, both in terms of the number of campaigns and the capital deployed across Europe, and again the UK was the most targeted country. But then the pandemic struck and obviously upended many things, including the strategies of the activists who effectively had the wind taken out of their sails at that point. And despite their reputation, the activists were pretty self-aware and feared being criticised for being opportunistic and self-serving in the time of crisis. We saw that they largely took a pretty realistic view, recognising that boards were focused, rightly, on the day-to-day operations, suring up balance sheets and in some cases fighting for the company's survival. And so crucially they knew that any wrongly-timed campaign would likely only harm their interests.
Filippo de Falco:	Yes. That's something that I certainly found interesting and I remember at the time a good example of this was Ed Bramson's campaign against Barclays. You'll remember he had been campaigning against Barclays for a good 12 - 18 months. He first bought a stake through derivatives of up to 5 per cent., used it to requisition a general meeting, tried to appoint himself to the board and lost that resolution resoundingly. But that didn't stop him and he continued to be vocal against Barclays, criticising its strategy and ultimately urging Barclays to withdraw its support for Jes Staley, the CEO. So everybody expected him to continue, and continue agitating for him to be voted down at the AGM. But actually when April came, at the peak of the pandemic, Barclays, like many other companies, had to navigate choppy waters and really focus on stabilising the company's performance, looking after its employees and handling

	the broader effects of COVID-19, even Bramson recognised that wasn't the time to start make more vocal attacks and entered into a sort of truce, confirming that he would abstain from voting on Staley's re-election. So that's not behaviour that you would typically associate with activists but I think in that particular climate it was perhaps not surprising. I think the reason isn't just that the world was coping with something that was so unprecedented, but also that ultimately any activist campaign is only successful if you bring onside the institutional shareholders. And of course those institutions were very much focused on the company having breathing space to steady the ship, to do the right thing by its employees and maybe not pay dividends whilst they try to sure up the balance sheet for that period. So it was unlikely that any activist campaign that tried to undermine that was going to get any traction amongst them and therefore any success. Finally, let's not forget that a lot of activists who already had exposure to the company would have suffered, like many other investors, from the volatility and the decline in share prices around March and April. The combination of all these factors meant that they effectively decided to adopt a 'wait and see' strategy, pending the world coming out of the other side of the crisis. I suppose in terms of deal activity and shareholder activity, that started to happen in the last quarter of 2020 didn't it?
Claire Jackson:	Yes. Exactly. In the summer and heading into the autumn, we were all facing the second wave of the pandemic, but activism was also having a bit of second wave of its own. We saw activists picking up in some cases where they left off from August 2020, and by the end of the year the number of campaigns had then exceeded the levels we saw in 2019, making 2020 a new record year. To take your Barclays example, in the summer Ed Bramson picked up the pressure again on Barclays and began pushing for it to cut its trading division to boost profitability. Another example which gained momentum again was Third Point's calls for Prudential to break up its US and Asian operations in the shorter term. By August, Prudential had announced that they would IPO the Jackson business. You might remember that Third Point had initially taken its stake in February 2020, back before M&A-driven campaigns generally paused along with M&A more generally, as you said. So what caused the rebound? Well I think some factors were growing confidence again among activists, particularly with M&A picking up, and pent-up demand from the beginning of the pandemic. That was also coupled with depressed share prices in the UK as a result of Brexit scepticism. That was 2020, Filippo, what do you think about the year ahead?

Filippo de Falco:	Well, it's an interesting question and it takes a brave person to make predictions in this climate, but let me try! There are two trends that we've seen and that I can imagine will continue. The first is M&A activism. We all saw that M&A dropped sharply in March last year but really rebounded and picked up more than people expected in September/October time, perhaps unsurprisingly given the weak pound in the UK and reduced share prices from all the volatility. So lots of opportunities for investors and, in the context of M&A activity, obviously opportunities for shareholder activists to do what they do very well, which is take stakes in companies that are being bid for, or that they think are about to be bid for, and try to demand and extract a higher price from the bidder and make a quick profit as a result of that tactic. Something along those lines happened with Countrywide, a property group who like many others suffered during the crisis and needed to raise money and struck a deal with private equity firm, Alchemy, to take a big chunk of the company in return for a cash injection and a valuation. At the time the Countrywide board was happy with this proposal but other shareholders, including new activist shareholders who came on the register for this reason, were not happy with and they thought the company was plainly worth a higher price. As a result of that agitation, eventually a bidder came along, Connell, that tabled a public bid at a much greater value, leading to a successful takeover, the resignation of then CEO and no doubt, a tidy profit for the shareholder activists involved. I think given that prices are still volatile and the pound is still relatively low, this is a trend that is likely to continue as activists seek out pricing opportunities. The second trend is not transactional at all and relates to governance and management. Given the turbulent times that companies have been through, there's bound to be a lot of scrutiny on how boards behaved and whether they did the right thing for the company and for the wider stakeholders. Did they take a pay cut? Did they make redundancies? Did they manage their supply chains properly? How was their corporate governance process generally? And did they remember to give due importance to other factors such as environmental or social and governance issues, and not just cash-flow retention and generation? I think that because those are arguments that institutional investors are very interested in, there will be a resurgence in activist agitation for board change, for other governance change, done with the benefit of hindsight, picking on targets that they feel haven't managed that aspect particularly well. And of course a focus on pay cuts and remuneration are topical and have been for a little while. So, in my mind, it's only natural that that's going continue.
Claire Jackson:	Yes. I completely agree with all of that. Let's take the Rank Group, the owner of Mecca Bingo. They faced a major revolt by more than a third of shareholders who opposed changes in the remuneration policy, which meant that the criteria

	for awards could be amended to take account of the COVID disruption, effectively increasing the likelihood of a pay-out. That was interesting because the opposition came despite the fact that the senior executives had already taken steep salary cuts in the first phase of the pandemic. We should expect that there will be continued scrutiny of all executive pay packages this year. That requires a pretty sensitive balance for companies. So, towing the line between incentivising management who are having to demonstrate significant leadership at the moment, against the interests of workers and other key stakeholders. 2021 might also see continued agitation, as you say, from activists for changes to boards they see as underperforming, and obviously they have the benefit of hindsight. An example recently was Cevian's campaign to pressure Pearson, the education publisher, who also unsurprisingly was hit hard by the pandemic, to appoint an external candidate to replace its outgoing CEO. Cevian took a 5 per cent. stake in June of 2020 and then upped that to 9 per cent. to try to push for a board seat for itself to enable it to oversee that succession process. This sort of agitation won't just be restricted to shaping identities of new CEO candidates, and we'll see scrutiny of the existing directors and an increase emphasis on directors being held accountable for ESG failings. An example that quickly springs to mind is Mike Ashley, who is the Chief Executive of Frasers Group, who came under fire recently for claims that employees at Sports Direct were asked to work while on furlough. That caused Pirc, the proxy advisory firm, to then urge shareholders to vote against Ashley's re-appointment as CEO. I think we can expect for that to continue.
Filippo de Falco:	Yes. ESG failings and concerns are going to be top of the agenda for many institutional investors, and also for activists. We've seen the likes of Schroders, L&G and Blackrock writing open letters to CEOs of boards telling them they need to focus not just on profit but also on environmental, social and governance concerns. Let's not forget many of these investors are themselves under some pressure by their own shareholders to burnish their credentials in this space and be seen as investing in companies that really put these to the top of their agenda. So that is a trend that has been growing over the years and people aren't surprised by. Activists have also picked up on this and you see new activists enter into the space that have advocated for change. For example, TCI has advocated for climate change for some time, achieving more success. TCI recently forced Aena, a large Spanish airport operator, to come out with a brand new climate plan and to submit it to an annual shareholder vote on a rolling basis. Others have tried to do the same; Climate Action 100+, for example, forced Shell to set emission reduction targets. This is another trend that is likely to continue and one where activists can expect to get some

	traction with institutions because they increasingly have mandates that really go to supporting companies that are good in this space
Claire Jackson:	Yes. I think that is going to be the case for social and governance factors too, especially as companies start to emerge from the pandemic and there is increased scrutiny on the way in which boards and companies have acted to treat the various stakeholders. What we'd say to corporates is that it's very important to make sure that management strategy is supported by a thoughtful corporate purpose which institutional investors can identify with and to keep the social and governance factors that we've mentioned in mind when building those ESG strategies and responses. Now that we've explored the trends in 2020 and made predictions for the future it's worth us thinking about what companies can do to prepare if an activist attack arises. The best defence to activism is strong company performance. Companies should be continually looking at how they are measuring up against their strategy and trying to pre-empt the weaknesses that an activist might try to attack. That would be my top starting point. What do you think, Filippo?
Filippo de Falco:	Pre-empting is definitely key here. You've touched on one of the ways that really does work effectively, which is to try to have an outside-in look at the company's performance and more generally spot areas that an activist might pick on as areas of vulnerabilities across the whole spectrum of matters we've been talking about. So not just financial performance, shareholder value metrics, but also how companies have fared in their ESG space. When they've been articulating their corporate purpose, has their strategy remained faithful to it? All of these areas that could be attacked, and an outside-in assessment will help companies prepare arguments to defend themselves if they do come under attack. The second point goes back to what we were saying earlier, which is that ultimately the companies will successfully defend against activists if they have support of their institutions. Therefore they should proactively and regularly engage with those institutions so that they can articulate their strategy properly, they are well understood and there isn't a risk that distance is created and that activists can drive a wedge between them, because you really will need to count on their support when the time comes.
Claire Jackson:	It's worth ending on a few practical tips. First and foremost, monitoring what's going on with the Register and disclosures above the key thresholds like 5 per cent. is an obvious one. Other warning signs might be a request by a shareholder for a copy of the Register under Section 116 of the Companies Act, because that could suggest the shareholder is trying to rally support from others on the Register. Secondly, alongside that monitoring it is important to brush up on the toolkit that activists have at their disposal in these in campaigns, such as the right to requisition shareholder meetings. These tend to

	be the sorts of things that clients don't come across every day and parts of the Companies Act that may not have been reviewed recently. Thirdly, tactics for responding to an activist. In our experience it's more likely to be the case that refusing to engage with an activist is unlikely to be a successful tactic. Early engagement is more likely to generate a successful outcome away from the public eye. So, for example, securing a relationship agreement with strong non-disparagement undertakings. And finally, our best practical tip is to manage an incoming activist like a defence to a takeover bid; having a defence plan and engaging the full team of advisers early on will help to guarantee success. That brings us to the end of today's podcast. Thank you all for listening, I hope you found it useful. If you'd like to discuss any of the points we've covered, or to plan your strategy for responding to a campaign, then please feel free to contact me, Filippo or your usual Slaughter and May contact. Thank you very much - bye for now.