

# Action against activism

When it comes to shareholder activism, the right kind of planning could help you avoid becoming a target. *Garnet Roach reports*

As investor activism campaigns have become more commonplace – and better publicized – an increasing number of companies are running vulnerability assessments to gauge exactly where the fault lines might lie, and putting a plan in place *before* an activist surfaces. But where do you start – and what should you be looking for?

## Good relations

‘What you need to do is front-load that so you’re doing what you frankly should be doing anyway: communicating well,’ says Scott Hopkins, a partner in law firm Skadden Arps Slate Meagher & Flom’s London office.

‘Having a well-performing share price is always the best way to deal with [activism]. But you also have to be out there communicating with the constituencies that are important: your shareholders, the analysts, the press. If you wait to start communicating until you’ve had an activist pop up and start a campaign against your management, you’re obviously going to be seen as being defensive.’

As well as being sound day-to-day business practice, having good communications also means that if a shareholder *does* start making a noise, ‘you know who the people are you need to speak to, and they know you and you speak to them on a regular basis – not just because you’re feeling threatened by an activist, but because you do things properly,’ explains Hopkins.

It’s not just your shareholders you need to focus on, either. Ed Bridges, senior managing director at

FTI Consulting London, says you need to think about the proxy firms advising your shareholders. ‘Ask yourself: *Am I seeing these proxy advisers as frequently as I should? Am I treating them as a de facto institution? Do they understand my corporate strategies?*’ he recommends.

As well as advising your shareholders to support you, putting in the work with the proxy firms means that if ‘an activist comes calling, the proxy advisory firm will really understand your company and [be able to] ask some meaningful questions of the activist,’ says Bridges.



**Bruce Goldfarb**

boards and shareholders,’ says Bruce Goldfarb, founder of Okapi Partners, the proxy solicitation firm that helped Starboard Value replace all 12 board members at Darden Restaurants in October 2014. ‘In many instances, boards are not even aware of who their largest shareholders are and how they might respond if an activist arrives on the scene.’

For Steven Balet, managing director at FTI Consulting New York, a vulnerability assessment is truly valuable only if it follows a perception study. ‘Normally this is done by a third party because you just get a more honest result,’ he points out. ‘You’re not going to be able to truly assess your vulnerability

until you have a good, third-party objective view of the company itself.’

Getting to know your register well also includes understanding how your investors vote and ‘how much weight they give to [the recommendations of] third-party proxy advisory firms,’ Balet adds.

But you can’t stop there: you also need to know who’s on the earnings calls and where the questions are coming from. ‘You need to understand who you are talking to, because they may be the activists that target you two years from now,’ Balet advises.

### Express yourself

Communicating with shareholders, proxy advisers and governance committees also entails ensuring they really understand your strategy – not just because this is good business practice, but also because it can help you in the event that an activist issue arises.

While there will always be aspects of your company strategy that remain confidential, it’s vital that institutions understand your mid-term to long-term plan. ‘Ultimately, someone could come along and say, *Why don’t we use that cash and pay special dividends?*’ explains Bridges. ‘You need to be able to say, *No, my shareholders understand where we stand on a three to five-year basis. They understand that the return on investment in all these areas is going to be greater than a one-off bump to shareholders in a special dividend, or whatever the reason happens to be.*’

Bridges suggests companies use their corporate reports to explain strategy. One example he cites is that ‘dividends now tend to be described in annual reports within the context of a broader capital allocation policy.’

Companies should also be prepared to articulate an action plan in the event that an activist investor attempts to publicly

challenge their lack of progress, says Goldfarb. ‘Directors and management need to make sure they

have a clear understanding of who their shareholders are, how they behave and what they care about. You can only do this by constantly monitoring your shareholder base and effectively communicating the company’s long-term strategy to significant investors.’

### Think the unthinkable

Once you’re confident that you know your shareholders, it’s time to look at your company from an activist’s point of view. ‘Get someone to think the unthinkable and measure the value that could be created by thinking the unthinkable,’ Bridges suggests.

‘That’s a key part in understanding where your vulnerabilities are.’ He advises companies to get a corporate finance assessment that highlights any ‘alternative views that could be taken by someone looking to extract cash from the business or realize value from a breakup’.

Companies can also get a good idea of how an activist might seek to target them simply by ‘conducting a review of any issues that may have been highlighted in prior reports by proxy advisers,’ says Goldfarb. Above all, ‘try as much as possible to be objective,’ he adds, though he admits this is not always as easy as it sounds.

### Get outside help

In order to really look at your company from an activist perspective, experts agree that you need to recruit an outsider. It’s critical to know whether someone could look at the balance sheet and argue that it’s being under-used or could be better used, or whether your company is a potential candidate for a breakup.

Because questioning whether you’re a likely target for an activist could be misconstrued as challenging



**Edward Bridges**



**Steve Wolosky**

the chief executive's strategy, Hopkins recommends first raising the issue internally in an emotionally intelligent way. Once you've decided you want to look at it, he advises engaging an investment bank or law firm that has already developed screens that can be run to assess your vulnerability.

'We do this on a regular basis so we know what the activist shareholders will be looking for and we know what the typical concerns will be,' Hopkins says.

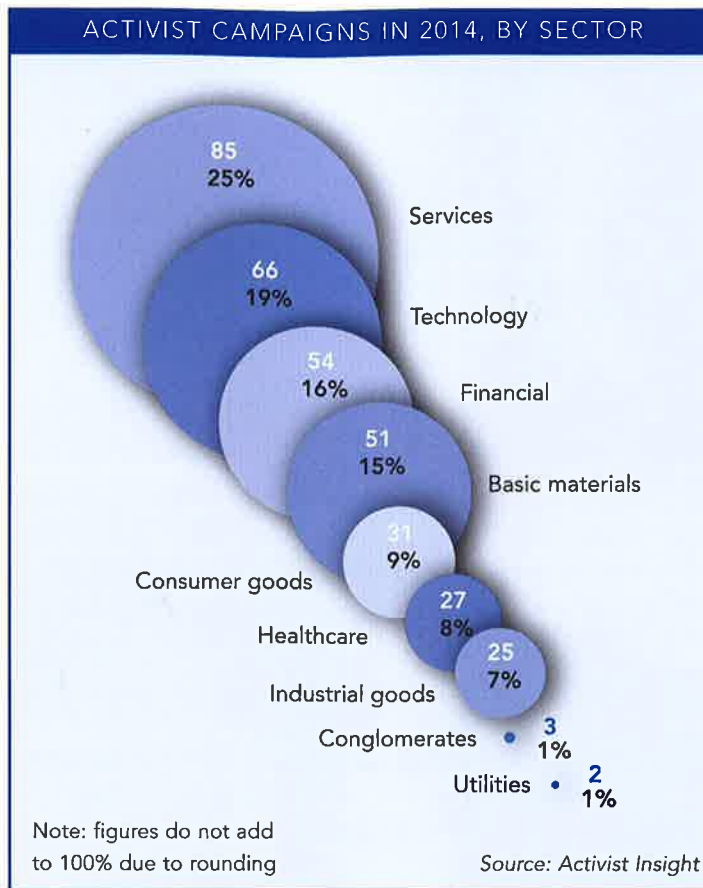
### Be proactive

Outperforming your peers might be the best defense against an activist, but 'there are no sacred cows in the market,' notes Bridges, citing Carl Icahn's campaign against Apple. 'Anyone of any size, shape or reputation could be attacked.'

Even if you think your company is immune, all firms could benefit from a look at where the fault lines might lie, says Goldfarb. 'Identifying potential vulnerabilities and enacting a strategic plan to rectify them is not only important in thwarting potential activism but is also sound business practice in general, because addressing any corporate deficiencies should ultimately enhance shareholder value.'

Being proactive also allows companies to avoid being caught flat-footed if an activist campaign develops, Goldfarb adds.

In addition to the tips above, you can take steps to 'prequalify' those advisers you might need to call on – often at short notice. By meeting with investment banks, law firms, PR agencies and proxy solicitation companies in advance, you can develop the relationships essential to combating a shareholder activist. What's more, because you will be trying to cover a number of different bases, it helps to form a team that comprises members of your investor relations, legal, public relations and corporate development/M&A departments, in addition to representatives from the corporate finance team and the CFO's office.



### Create a checklist

When putting a plan in place for a potential activist attack, it's easy to lose sight of those necessary day-to-day tasks. Taking care of little administrative details in advance, however, 'allows the mechanics to operate so that people don't spend their time running around trying to figure out what they should be doing as opposed to thinking about the real, core issue,' says Hopkins.

In this vein, there are some key questions that can be asked ahead of time and roles that can be assigned, says Balet. Work out 'who is going to talk to the activist, which board members are going to be involved should it escalate to that point, how you handle that initial engagement without divulging inside information and how you can engage productively with the activist and set the right tone.'

Companies can also decide in advance who's in charge of researching the activist and which sources to call, as well as the approach to take when dealing

with a more aggressive activist, says Balet, who also suggests preparing holding statements. One often overlooked area, depending on how public the activist goes, is determining how you answer questions from employees, customers or suppliers, he adds.

Advanced planning can make a big difference in the early stages, Balet continues. 'Your initial engagement with an activist investor sets the tone for how any future engagements are going to go and whether you can resolve privately and without any pain for either party.'

### Get your press policy in order

While the best activism campaigns might be those nobody hears about, you need a clear policy – agreed upon in advance – detailing how to handle press queries. As well as developing relationships with the press during good times, a company could prequalify PR firms it wants on its side, as mentioned above.

'Being unresponsive to journalists is never a good thing, and you can bet the activists are conveying their message to reporters behind the scenes on a daily basis,' says Zach Kouwe, vice president at Dukas Public Relations. It's also wise not to 'dig your heels in', as this 'not only looks unbecoming and defensive but also draws the media's attention to the conflict aspect of the story rather than the validity of the actual ideas about long-term strategy.'

### Keep the board fresh

Shareholder activism isn't only about the share price. Many campaigns focus on governance, so it's critical to evaluate your board, says Steve Wolosky, partner and chair of Olshan Frome Wolosky's activist and equity investment practice. Generally, institutional investors like to see new blood on the board as a company changes instead of directors who have all served 20 years or are overly close to the CEO, he says.

'Constantly analyzing your board to ensure the right mix of directors and being proactive in bringing in new directors is important,' says Wolosky. If you can't or don't want to recruit new

directors, make sure your shareholders understand why those you have are critical to the company by highlighting their qualifications, experience and value. This will prove popular with the proxy advisory firms and shareholder associations as well.

### Know your activists – and listen

As well as explaining how their current strategy is creating value for shareholders, 'companies should be open to dialogue with activists, which often have interesting ideas and can be a catalyst for value-added change,' says Kouwe. 'This is important even if only to know how best to counter an activist's proposals.'

Smart activists do their homework, spending time researching a company and becoming knowledgeable about the company's industry, says Wolosky. 'To the extent that they aren't knowledgeable, they bring in independent consultants and advisers to help them. They study the balance sheet, they listen to the conference calls, they are generally smarter and better educated about the company than even the directors in many ways.'

A company needs to understand an activist's investment thesis if only to clearly articulate why it thinks that thesis doesn't make sense for the firm, adds Hopkins.



Zach Kouwe

### Revisit your strategy

Running a vulnerability assessment – and even putting together your response plan – should never be considered a one-time exercise. 'Once you run [a vulnerability assessment] for the first time and you see where the fault lines are, people will be much more aware if something is traveling in a particular direction,' says Hopkins.

Both the business climate and the climate for activism will change, so companies must constantly monitor their registers and revisit their strategies regarding potential activism at least once a year. 'In this world, it's very much the case that an ounce of prevention is worth a pound of cure.'

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