

Shareholder Activism

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Thomson Financial Corporate Services

Executive Summary

Overview

Thomson Financial Strategic Research examined 75 recent instances of shareholder activism. In so doing, we came to several conclusions and suggestions how to best respond an activist approach.

Shareholder activism is a phenomenon that has developed as a sort of “hostile takeover light” in response to the end of the era of corporate raiders, and has gained traction in recent years as instances of corporate malfeasance hit the headlines. Activism does not appear to be a transitory phase in the US equity capital markets, but rather an ongoing reality that management and investors will have to deal with going forward.

Although the ultimate outcome of a specific occurrence of shareholder activism is largely outside of any individual’s control, understanding and preparing for these things ahead of time can allow management to craft a more appropriate response, and more effectively communicate that response to their investors. To address these concerns, Thomson Financial has created a step-by-step checklist entitled “How to Respond to an Activist” at the end of this executive summary.

Key Findings

- Thomson Financial found that stocks which have been the target of shareholder activism do in fact measurably outperform in both short and longer run terms relative to a control group, and relative to same stock before-activism period returns. Some results were significant to the 95% level.
- Recent studies find that activists have been relatively successful in achieving their demands, and rates of success may be increasing over time. Our case study also found that activists do achieve at least one of their goals 45% of the time.
- Success rates may vary by sector, by the specific investors involved, and by type of request. Of note, activists are successful when targeting the removal of the CEO nearly 80% of the time, the highest success rate among all demand categories.
- Stock price performance after the contest outcome indicated that a failed activist campaign results in dramatic pressure on pricing, whereas a victory by the activist resulted in outperformance.
- Target firms – who’s at risk? By far, the most frequently targeted sector was consumer discretionary, with 41% of the instances from our sample falling into this category. This virtual assault on the consumer discretionary sector appears to have been focused largely on restaurants and retailers. Industrials were second, with 21% of the cases, and healthcare (nearly all biotech) companies were targeted 11% of the time. Target companies often share several other characteristics, including smaller market capitalization, substantial cash holdings, lower valuation multiples vs. peers, and slightly inferior stock performance.

Chart 1: Shareholder Request Frequency

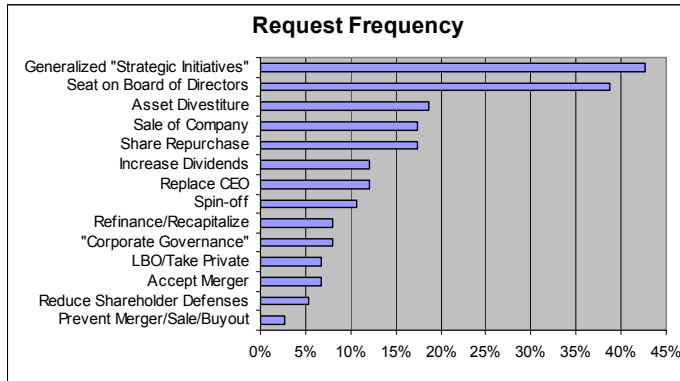
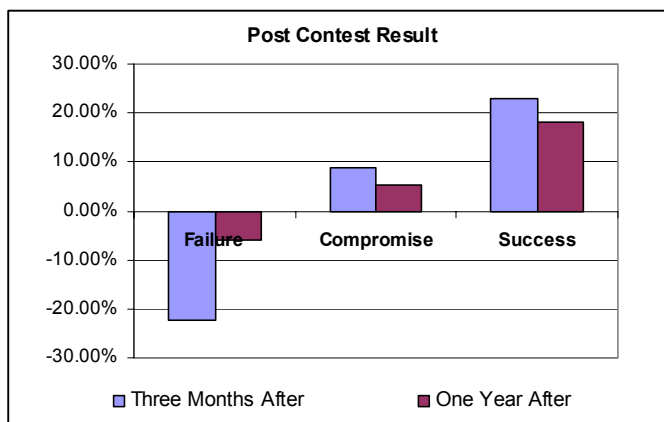


Chart 2 – Results of Shareholder Activism



Chart 3 – Stock Returns by Outcome



THOMSON TEAR SHEET

How to Respond to an Activist

Prior to Activism: Prevention

- 1) Step One: Create an internal response team to address potential instances of shareholder activism. Include key officers, investor relations, legal department, stock surveillance firm, proxy solicitors, and investment bankers. Ensure this team has the ability to convene within 24 hours of an approach by an activist.
- 2) Step Two: Monitor shareholder base and proactively manage relationships with top investors. Know who your investors are, what their strategies and investment time horizons are, and any potential concerns they may have. Keep senior executives and board members apprised of big movers and shakers.
- 3) Step Three: Build a unified message. Understand and address investor concerns regarding possible issues or shortcomings ahead of time, and proactively create responses to suggestions or proposals. Ensure the message is standardized and internalized so there are no mixed messages.

After a Public Approach: Response

- 4) Step Four: Create an open communication channel with the activist. Do not ignore them, and hope they will go away. This often will result in a PR battle in the media. Listen to their concerns, because in many cases they are genuinely trying to boost shareholder value. Most importantly, do not ever become hostile, as this will only hurt management's position, both with the activist and the investing public in general.
- 5) Step Five: Carefully review the proposals and gauge shareholder support. Understand the activist's goals, and perform all required due diligence. Realize they may in fact have some good ideas. Stock surveillance and proxy solicitors will play a critical role in breaking down how a potential proxy battle may play out.
- 6) Step Six: Determine the appropriate response. It is important that the board act decisively in due time, whether they agree with a proposal or not. Do not simply pay lip service to a decision to pacify investors, as this only weakens management's credibility, but also do not waffle. Formulate the response, with supporting arguments, and implement the plan.
- 7) Step Seven: Continue to manage relationships with top shareholders and gather feedback regarding strategic and financial plans.

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