DEALING WITH Activist Shareholders

Staying vigilant and proactive is the key for IROs

By Peter Brinch

Shareholder activism in the United States began about a century ago, and its history is replete with gadfly characters and miscreants. But as Shakespeare observed, "what's past is prologue." Or to translate into a 21st century sound bite, "you can't fight today's battles with yesterday's weapons."

The weapons today revolve around technology. With the advent of fiber optic cable and commercial satellites, access to the World Wide Web has exploded, making trading in equities markets a 24/7/365 proposition.

The irony is that while the global game has quickened, business is both more complicated and transparent then it was even a decade ago. Access to more information and the ability to repurpose and distribute it instantaneously means that aggressive investors can quickly mount powerful campaigns against a company's management.

A Sea Change

There is no question that in recent years there has been a sea change in the tactics used by activist investors to achieve *their* stated goal of increasing value for shareholders. Today's reality is that there is no safe harbor for the unprepared public corporation. If warnings are not recognized and heeded, the result is a perfect storm of media and market frenzy—interrupting business and putting a company's management and its growth objectives under a microscope.

Waheed Hassan, CFA, managing director of Alliance Advisors LLC, a firm specializing in contested situations, describes the current landscape: "Activism has become an accepted investment class; activist investors are now targeting bigger companies. Additionally, these investors are getting involved with issues that have been the board's traditional purview. Timken [which spun off its steel business after pressure from two major shareholders in September 2013] was an inflection point and provides a blueprint for targeting operational and strategic issues without being on the board."

So in today's stock markets, any risk, or perception of risk, can lead to institutional shareholders abandoning ship, and leaving the door open for activist investors or hedge funds to step in. Invariably this leads to a disruption of daily operations, and diverts management's focus to the looming crisis, most often to the long-term detriment of retail shareholders.

Although many legal and academic scholars have pointed out that in addition to being at odds with management's fiduciary duties, the *ad hoc* connections and alliances formed between activists, trial lawyers, and issue-advocacy groups often are of little or no benefit in increasing long-term shareholder value.

But the first rule in a free market is that money talks! Today with assets under management over $65 billion, activist investors and hedge fund managers are no longer focused on small- and mid-cap companies.

Recent stories in the media document that even blue-ribbon companies with share price performance consistent with their peer group, outstanding balance sheets, and exemplary corporate governance practices can, for any number of reasons, fall victim to activist agitators who initiate proxy battles, shareholder resolutions, and litigation threats.

In its third quarter market capitalization analysis, *Activism Monthly* states that business boomed as 2013 got off to a strong start, showing "the amount of money spent by activist investors acquiring new stakes in U.S.-listed companies had grown by a third."

According to *SharkRepellent*, as of September 2013 there had been 23 contested meetings and an additional 34 this year that were settled prior to the shareholder vote, reinforcing the notion to the market that serious activists with deep pockets and the proper strategy can make any company vulnerable and therefore put it in play.

An article in the May 25, 2013 issue of *The Economist* chronicles the recent travails of several large-cap corporations, among them Sony, Apple, and most recently, Microsoft. Those companies are being badgered by billionaires, hedge funds, and a wide variety of activist investors and interest groups who join forces and try to enlist the support of retail shareholders to promote specific "reform agendas" or "management changes."

Proactive Preparation is Key

Recognizing that activists are building new alliances daily and have the tools, time, and techniques to disrupt their plans and objectives, companies must be proactive and adopt the Boy Scout slogan, "Be Prepared."

Since each situation is unique and the resulting problems are multifaceted and come from many directions, it is absolutely critical for C-suite executives and their IROs to recognize they have a dual

responsibility—to focus on the present and keep their eyes trained on the horizon for pending dangers.

Activist investors typically look for situations where a company's management and/or board are viewed as vulnerable and the stock has underperformed versus expectations or past performance. Then, depending on the situation they have two basic game plans.

Plan A is to take a large, long position in the stock and use outreach tactics such as writing to the board and sending press releases to financial news outlets. This generally attracts speculative interest in the stock and can quickly drive up share price, which allows the activist investors to exit their position at a quick profit or "hunker in the bunker" for a protracted battle to gain some measure of control of the company.

Plan B is to take a short position, then publicly challenge the company's financial controls, accounting policies, product marketing plans, or long-term viability. This plan has the potential to backfire if other large investors rush in to support the company through significant stock purchases.

Regardless of the method an activist uses, Brian Turcotte, vice president of investor relations at ServiceMaster, sees his day-to-day job as: "Communicating the company's message to our constituents in the financial community and bringing the voice of the financial community back to management. But if my company comes under siege, we are prepared to switch gears and expand our communications outreach."

Gene Grabowski, executive vice president in the Washington, DC office of global communications firm Levick, agrees that this is the proper approach. He says, "In this age of instant transparency, companies must manage the narrative of relevant issues in order to maintain market share and stock value, and ultimately control their own destinies. To ignore this reality is to invite disaster."

To counter any actual or impending threats, the IRO should remember the adage, "Keep the spectators off the playing field." Those words, attributed to Norm Augustine when he was CEO of Lockheed Martin Corp., should be the mantra for corporate executives and their IROs. In today's world, if you're going to win for your shareholders, you must keep your eye on the ball, have a game plan, and be willing to get on the playing field.

Communicate Value and Vision

Historically, and especially today, investors are obsessed with quarterly results, so communication with all constituencies is paramount. Even if earnings are off or analysts' forecasts are pessimistic, the overall goal must be one of telling and selling the company's value and vision to the marketplace. If shareholders know there is a plan in place and management can execute, it becomes a solid foundation for fending off the unwelcome advances of activist investors.

Patrick Davidson, vice president of investor relations at Oshkosh Corp., believes, "It's best to recognize your company's value proposition and be prepared for the possibility of activists before they come knocking, otherwise you're playing defense before the game starts."

Turcotte agrees, especially when changes are in the wind. He suggests, "When struggling or implementing a transformation, before hitting the radar screen of an activist investor, be sure to effectively communicate your company's performance and strategy to large shareholders and widely followed sell-side analysts."

Hassan believes that since every activist has a different playbook, most companies are at a disadvantage "unless they have someone on senior staff or the board who has been involved with activist campaigns." So proactively preparing for potential areas of activist criticism is vital.

Grabowski whose firm has played on both sides of the field by representing corporations and activists weighs in by adding, on the corporate side, "Our experience has demonstrated that before a situation becomes lethal, the IRO working on behalf of senior management should assemble a team of in-house staff and outside consultants.

"Generally an outside team consists of senior experts from banking, legal, public relations, and proxy solicitation firms. It's the IRO's job to effectively coordinate both face-to-face and electronic communications efforts among team members. Common sense and special attention must be given to security protocols when using electronic technology. The result should be clear, concise, and consistent communications that detail current activities and possible future scenarios."

Once the team has been assembled, the first thing to be done is review existing structural defenses and consider new ones in view of both current legislative and regulatory realities. Then, if necessary, the IRO should brief and make recommendations to management.

The plan, which is always a work in progress, should include detailed media tactics and designated spokespersons. It should also document methods and company contacts for cultivating relationships with third parties including institutional investors, sell-side industry analysts, customers, business partners, and any "new influentials" who appear on the scene.

Summing up, Turcotte says, "Don't let it get personal and always take the high road. IRU

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