The 2018 Proxy Season

Key Takeaways

The recently concluded 2018 proxy season (the 12-month period ending June 30 that encompasses most public companies’ annual shareholder meetings) was a year for large shareholder activists to return to the fore, proving that brief declines in assets under management do not undermine the strategy and volatile periods serve only to harden the focus of activist funds and further expand their horizons. With direct activist AUM at $127.5 billion1 as of June 30 and a strategy that institutional investors continue to embrace, shareholder activism is expected to remain strong and continue to evolve as it weaves itself into the fabric of global capital markets.
Campaign volume slightly down, but assets deployed up

Campaign volume in the 2018 proxy season decreased by [3%], with [651] new campaigns launched globally, down from [669] in 2017. However, lower volume doesn’t mean that shareholder activism is slowing, as it does not necessarily translate into less capital deployed. Having spent recent years focused on shoring up liquidity, a number of activists made some of their biggest investments ever in the past 12 months. Several funds showed they favor bigger bets and larger single investments over multiple simultaneous campaigns.

TCI Fund, Altaba’s largest shareholder with a nearly [7bn] position in the company, launched a campaign calling for a liquidation of Altaba. TCI built its stake in the company in 2016 but only initiated its campaign in March 2018, encouraged by recent tax cuts.

Trian Fund took a $3.5bn stake in Procter & Gamble, the largest company to ever face a proxy contest. P&G narrowly won the shareholder vote against Trian, but ultimately appointed Nelson Peltz to its board, given the extremely narrow margin of victory and feedback from shareholders during the campaign.

P&G was not alone. The season showed signs of a continued appetite for larger targets.

- **200** campaigns targeted companies with market capitalization of over $1bn.
- **68** campaigns aimed at companies with market cap >$10bn;
- **57%** of them targeted non-U.S. companies, which have now become some of the largest companies ever to face a shareholder activist.

In the U.S., SharkWatch50 investors, the most prominent activist funds, championed a significant proportion of large- and mega-cap activism.

They account for **32%** of all U.S. activism activity and

**45%** of targets >$10bn.
As a result of its ever-expanding profile, shareholder activism — now a fixture in European, Asian, and Australian markets, as well as the U.S. — is edging into frontier markets such as Israel and South Africa. Increasing success is likely to accompany the geographic expansion as global institutional investors, who have long supported activism in the U.S., side with activists around the world.

Proxy contest update: In the U.S., volume was flat, with 77 fights announced in 2018 versus 78 in 2017. Of this season’s 61 completed contests:

Activists achieved at least partial success 77% of the time, meaning shareholders voted for at least one of the dissident’s proposals at the meeting, or concessions were obtained from the target via settlement.

Activist effectiveness at contests that go to a shareholder vote remained relatively steady. So far, 18 of the contests announced during 2018 reached a shareholder vote, versus 28 in 2017.

37 were resolved with settlements, the most frequent single outcome, up from 28 in 2017

Dissidents succeeded at least partially in 56% of 2018’s contests and 43% of 2017’s.
M&A continues to drive activist agendas

M&A-related items continued as a significant part of the activist agenda. Calls for corporate breakups remained common, with conglomerate structures coming under intense scrutiny.

“UTC fits a pattern of many underperforming conglomerates where value is diminished by the ill effects of a ‘one-size-fits-all’ approach to corporate strategy, incentive compensation, and capital allocation[.] To reverse its years of underperformance and realize the full potential of its franchise assets, we believe UTC should split into three focused, standalone businesses.”

May 4, 2018
Third Point’s first quarter investor letter

Activists have evolved beyond calls for sales, which remain quite frequent, to demands as sophisticated as the reshaping of a company’s corporate structure, not only suggesting which assets to shed but also how to reorganize the ones that remain.
**July 2017**
Trian Fund proposed that P&G reorganize its matrix structure because the fund believed it added complexity and impeded accountability.

**April 2017**
Elliott Management criticized Korean conglomerate Hyundai's announced restructuring plan, saying it addressed its inefficient circular holdings but did not resolve other issues that also contributed to the company's significant discount. Hyundai scrapped the plan following significant shareholder opposition and unfavorable proxy advisory recommendations.

### Global Activist Campaigns Containing Select Value Demands*

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<tr>
<th>Demand Type</th>
<th>M&amp;A-related</th>
<th>Capital structure-related</th>
<th>M&amp;A-related forecast</th>
<th>Capital structure-related forecast</th>
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<tr>
<td>Total campaigns</td>
<td>192</td>
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<td>M&amp;A-related with at least 1</td>
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Source: SharkRepellent and Activist Insight as of June 30, 2018. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

* Individual campaigns may be classified under various value demand

Continued focus on M&A is seeing bolder activists go as far as becoming the acquirers themselves. In the past year alone, Elliott Management, through its private equity arm Evergreen Coast Capital, successfully acquired network software firm Gigamon for $1.6bn and, most recently, made a $6.9bn offer for healthcare-focused IT company athenahealth. Third Point recently raised $550mm for a special-purpose acquisition vehicle to focus on acquisitions in the fintech industry.
Board representation – not itself a primary campaign goal, but rather a mechanism to advance the activist agenda from within the company – remained a frequent activist strategy, with 334 global campaigns including a demand for board seats during the 2018 proxy season. In the U.S. alone, 63% of completed campaigns1 yielded at least one board seat for the activist, signifying a total of 199 seats changing hands. Overseas, we saw recent high-profile wins like Telecom Italia's, where Elliott Management succeeded in electing 10 directors to a 15-seat board.

Global Campaigns Containing a Demand for Board Seats*

Source: SharkRepellent and Activist Insight as of June 30, 2018. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

* Includes campaigns seeking board representation for the activist or the addition of independent directors to the board.

Environmental, social & governance (ESG) issues increasingly important

Governance institutional investors have spent recent years redefining their roles, often becoming more assertive. These funds now regularly support dissidents at the ballot, and even launch their own campaigns when they deem behind-the-scenes engagement ineffective. As of June 30, 2018, the top 10 institutional shareholders owned 31% of the S&P 500, a material increase from the 24% in 2008. As more capital flows into these institutions, their leverage with issuers will increase, and so will activists’ desire to enlist them as supporters.
Institutional investors are setting clear criteria of what they believe good governance should look like:

**BlackRock:**
Announced that CEOs who sit on more than one public company board besides their own are “overboarded” and threatened to vote against them as part of an update to its voting guidelines.

**Vanguard:**
Published a series of letters to shareholders and boards, outlining its four pillars for evaluating corporate governance practices: independent and diverse boards, strong governance structure, appropriate compensation and effective oversight.

**CalPERS:**
Wrote to 504 companies in the Russell 3000 outlining growing evidence that board diversity has a positive economic impact on business performance and asking each company to develop and disclose its corporate board diversity policy and its plan to address the lack of diversity.

This past year, however, saw these funds make not just governance but also environmental and social matters key focus areas. In its 2017 annual report, Vanguard stated it is discussing climate risk with portfolio companies more than ever before, and that for the first time, it supported climate-related shareholder resolutions opposed by company management. BlackRock said it may vote against directors or proposals when it thinks a company may not be dealing with E&S matters appropriately. Going forward, companies must be cognizant of their impact on the environment and broader society as institutional shareholders will increasingly hold them to account on these issues.

“To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.”

CEO of BlackRock, Larry Fink’s annual letter to CEOs, 2018

Proxy advisory firms are embracing the trend: ISS announced the launch of the E&S QualityScore, which will not affect its voting recommendations but is aimed to measure the quality of corporate disclosures on environmental and social issues, including sustainable governance along with identifying key disclosure omissions.

Environmental and social activist funds, whether by conviction or to appeal to institutional investors and LPs by making their strategy more palatable, have begun pushing ESG issues forward — some, officially incorporating ESG into their investment philosophies, others going as far as launching funds to exclusively focus on ESG matters.

**ValueAct Capital:**
Launched its Spring Fund with the aim of promoting social and environmental goals. The fund has already taken stakes in power producer AES and in Unifi, a company that makes nylon and polyester textiles out of recycled plastic bottles, among others.

**JANA Partners:**
Started the Jana Impact Capital Fund and enlisted help from Dan Hanson, who previously managed socially responsible funds at BlackRock.

**Trian Fund:**
Stated that ESG factors are taken into consideration as part of its overall investment process. Said it leverages its board and committee positions to raise the issue of ESG risks and opportunities with senior management and other directors.
Notable Emerging Trends

Multiple activists

In recent months, a number of companies have found themselves in the crosshairs of more than one dissenting shareholder. This isn’t a new trend, but it has grown more visible as targets have become increasingly large. Companies now need to prepare to deal with multiple activist investors that are either supporting each other or pursuing conflicting agendas. Newell Brands had to appease two of the most aggressive activist funds, giving both Carl Icahn and Starboard Value a total of five seats on its board.

In the U.S., 63 companies were publicly targeted by more than one activist in the 2018 proxy season. This is relatively flat from 59 in 2017. However, companies with market capitalization over $10bn increased to eight from five in 2017 and up from seven in 2015’s peak. Even with no public campaign officially launched, the presence of more than one activist in the shareholder register exerts pressure on a company. JANA Partners initiated a campaign at Pinnacle Foods a few months after Dan Loeb’s Third Point disclosed a stake in the company. Both Third Point and Pershing Square recently built positions in United Technologies.

Activism abroad mirrors this trend. During the 2018 proxy season, Whitbread found itself across the table from both Sachem Head and Elliott Management. Additionally, Elliott disclosed a stake in Thyssenkrupp, adding to existing pressure from Cevian Capital.

% of All US Companies Targeted by More than One Activist with Market Capitalization of Over $10bn

Source: SharkRepellent and Activist Insight as of June 30, 2018. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

* Individual campaigns may be classified under various value demand categories
Universal ballots

Typically, during contested director elections, companies and activists each produce their own proxy card listing only their own nominees. Only investors who attend meetings in person can select candidates from both sides, while those who vote by proxy – the vast majority of shareholders – are forced to choose between incumbent and dissident nominees only, disenfranchising investors who would prefer a mix of nominees not available on either card. Universal ballots allow director nominees from both sides to be listed on the company’s proxy card, enabling shareholders to select from all candidates when casting their votes.

In October 2016, the SEC proposed amendments to require the use of universal proxy cards in contested elections, facilitating investors’ ability to vote for their preferred combination of candidates – a move supported by the Council of Institutional Investors. With the SEC silent on the issue recently, it’s likely that the regulator has cooled on the topic. However, governance minded institutional investors are likely to continue pushing companies on the idea.

Both companies and activists have attempted to use universal ballots in recent years, but the requests have mostly been rejected. In 2015, Shutterfly suggested the use of a universal card in its contest against Marathon Partners. So did Trian and Pershing Square in their DuPont and ADP campaigns, respectively. All requests were rejected by the opposing party. In a September 2017 letter, ADP argued that changing to a universal proxy card would create confusion and disruption, thus interfering with the conduct of a fair and accurate election. However, recent developments are signaling a shifting paradigm. In May 2018, Mellanox Technologies’ shareholders approved a proposal to require the use of a universal ballot in case of a contested director election. In June 2018, a universal card was used in a U.S. proxy contest for the first time in the showdown between SandRidge Energy incumbents and Icahn nominees. Parties settled at the last minute, expanding the board size from six to eight, granting Icahn five seats. Regardless of the settlement, final voting results show that shareholders voted in favor of all five dissidents on the ballot.

Increasing momentum in Europe

Shareholder activism became normalized across global markets during the 2017 proxy season; this year, Europe confirmed its position as a major shareholder activism arena. Of the 318 non-U.S. activism campaigns initiated in the 2018 season, 128 (representing 40%) targeted European companies, a number of those representing some of the highest profile campaigns launched in the past 12 months.
Over the past two years, a clear trend has developed in Europe toward larger targets. In 2018, companies with market capitalization over $10bn accounted for 23% of all European activism activity, higher than in any other region. While this number is relatively flat compared to 2017, campaigns targeting companies with market capitalization between $5bn and $10bn soared to represent 13% of all activity, up from 5% in 2017. In the past year, Sherborne Investors launched a campaign against Barclays, RBR Capital targeted Credit Suisse, and Third Point continued its engagement with Nestle. The trend toward European large- and mega-cap activism will continue, as this size range has not been over-targeted, as it has been in the U.S.

This over-saturation is also driving the influx of U.S. activists in the region. Non-European activists have stepped up their efforts in Europe, initiating 43 campaigns in 2018, up from 39 in 2017. Almost 75% of those campaigns were launched by U.S. funds looking for viable targets outside their saturated home market. Both Corvex Management and Sachem Head launched their first European campaigns this past year, while Trian Fund is said to be raising a U.K.-listed fund to target a European company.
Activism campaigns in Europe: targets with market capitalization greater than $5bn

Source: SharkRepellent and Activist Insight as of June 30, 2018. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

M&A-related items were activists’ top concern in Europe: 35% of campaigns had at least one M&A-related demand, 12% sought to oppose an announced transaction by demanding an improved consideration or seeking to block the transaction entirely, and 23% aimed at catalyzing a deal by calling for a strategic review of alternatives, a spinoffs, split or full sale. Board seats provided a common avenue for activists to pursue their ultimate value-related goals, with approximately 48% of campaigns including a demand for representation in the boardroom.

Activists’ success in Europe has been rising and is expected to continue to increase.

Shareholder registers in Europe increasingly comprised the same global institutional investors seen in U.S. shareholder registers: European issuers are finding themselves with a significant number of shareholders who have proved their inclination to support an activist, if one emerged, and even initiate a campaign. As an example, the top 10 institutional shareholders of the S&P 500 own 17% of the FTSE 100, almost double the 9% from 10 years ago; the top five own 13%, up from 8% 10 years ago.

Recent high-profile wins are encouraging investors, showing the strategy in the region bears fruit: In the past year alone, Clariant was pressured into calling off its merger with Huntsman, Qualcomm increased its offer for NXP, Whitbread announced it would spin off Costa Coffee, and Akzo Nobel sold its specialty chemicals unit after adding independent directors to its board.
Tactics evolving to appeal to a wider investor base

Increasingly focused on capturing retail investor support — which has been decisive in a number of recent high-profile contests — activists are innovating with ways to get their message to the shareholders who do not normally read filings or follow the financial press. Some funds have recently leveraged new media alternatives. Beyond social media platforms such as Twitter and Facebook, activists now also rely on paid ads to prioritize their content online and maximize traffic toward their campaign microsites. Pershing Square’s Bill Ackman hosted a series of live webcasts to court ADP’s retail shareholders, while Paul Singer’s Elliott Management distributed video players to push its content out to Arconic investors. Elliott Management is at the forefront of these novel tactics, having also set up billboards in different Australian cities to engage with BHP shareholders.

Social Media  Paid ads  Video messaging  Live webcasts

Icahn:
Hired Matthew Grubb, former SandRidge Energy COO, as a consultant to advise on its campaign at the oil and gas company, as well as John Visentin, a former HP executive, to assist on its campaign at Xerox.

Starboard Value:
Teamed up with former Newell Brands directors Martin Franklin and Ian Ashken to replace the food operator’s board. Franklin had sold his company Jarden to Newell approximately a year before and was seeking to regain control after resigning from the Newell board along with two other directors. Jim Lillie, former Jarden CEO, also worked with Starboard and Franklin on the proxy contest.

Trian Fund:
Hired Clayton Daley, former Procter & Gamble CFO, as a consultant.
Implications for companies

Regardless of the specific criticism or value creation proposition, activists worldwide now command the attention of companies they target. Dismissive boards and management teams will face increasing pressure and harsh criticism if they refuse to engage. To be clear, engagement is not the same as capitulation, but issuers must be able to demonstrate that they are open to hearing the views of all shareholders, even those who may have an activist intent. Management teams and boards should then consider that input when making decisions on behalf of the company and all of its shareholders.

Establish external and internal working teams

1. Establish internal activism team including key members across corporate functions and operating segments
2. Engage roster of best-in-class activism advisors
   - Investment bank
   - Public relations firm
   - Attorneys
   - Proxy solicitor

Evaluate strategic planning through the lens of an activist

2. Update financial projections by segment, with reflection on peer benchmarking
3. Consider the strategic importance of each segment and whether the market gives the company “full credit” for the value of the current corporate structure
4. Determine optimal capital structure

Complete scenario planning / fire drills

3. Analyze vulnerabilities and produce a mock activist attack deck
4. Prepare standard responses to anticipated campaign attacks
5. Prepare internal and external communication materials

Monitor shareholder base

4. Closely monitor shareholder base on an ongoing basis
5. Understand shareholder motivations

Board should receive updates at least annually

4. Directors should be prepared for spotlight by activist
5. Banker and lawyer updates with directors
   - Current environment
   - Fiduciary duty
   - Legal considerations
6. Proactively determine governance deficiencies and adopt required policies