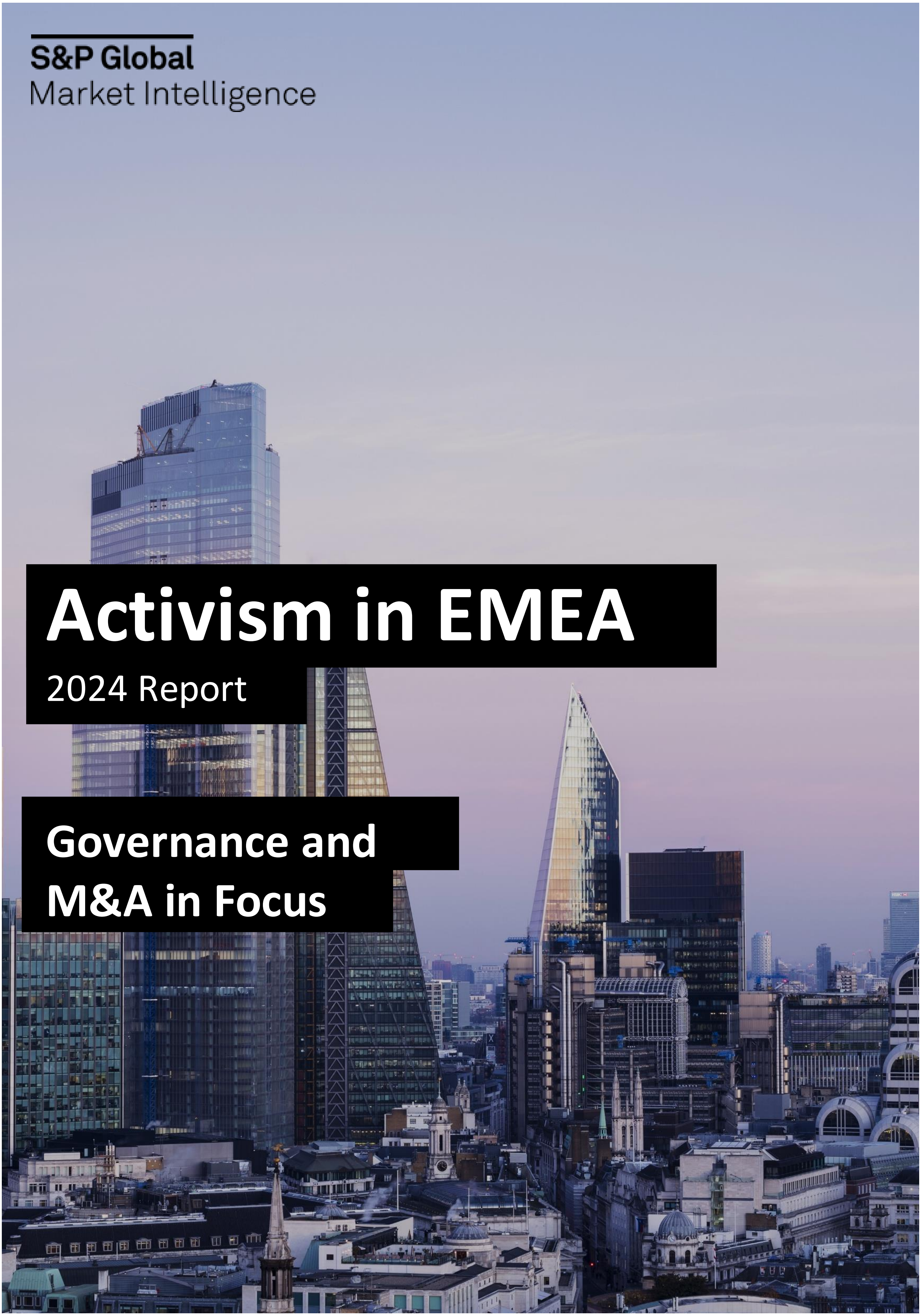
S&P Global
Market Intelligence

Activism in EMEA

2024 Report

Governance and M&A in Focus

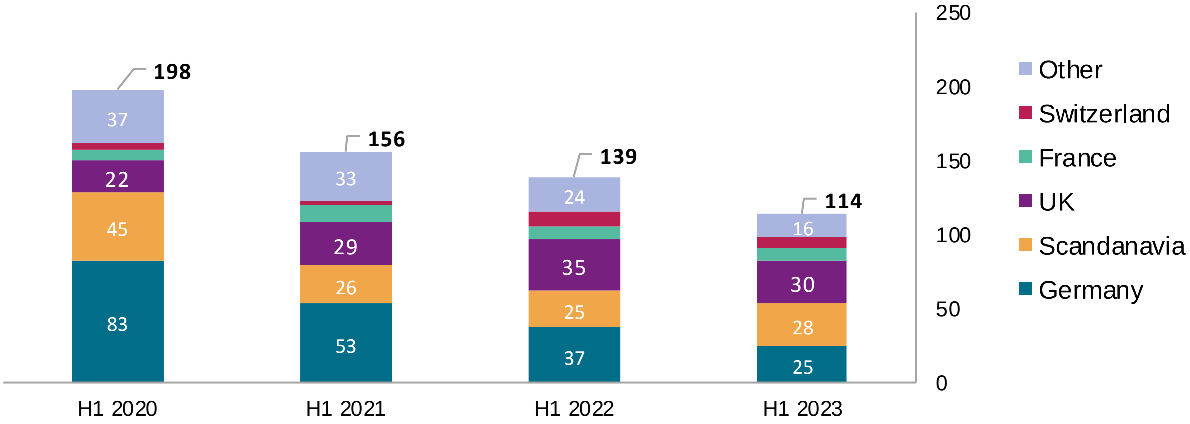


Introduction

No type of shareholder engagement is more directly impactful than activist investment. For boards and IR departments, an activist buying in often appears shortsighted, overly critical, and generates substantial concerns. Given the magnitude of the issue, it is essential to be aware of the overall state of activism in the market. Which sectors are being targeted? Has activism increased? How have the demands of activist evolved over time? S&P Global Market Intelligence has produced this research report to answer these questions, helping ensure that issuers go into 2024 well-informed and with confidence.

2023 saw the number of activist campaigns in EMEA continue its downward trajectory. Since 2020, there has been a steady decrease, with the lowest levels occurring in 2023.[1] This trend is partly a result of the pandemic-related global slowdown, market uncertainty, continued geopolitical issues in Europe, and increases in inflation and interest rates. The busiest regions for activist campaigns continue to be the UK, Germany, and the Scandinavian nations.

Activism Campaigns by Country (H1 2020 - H1 2023)



Despite what appears to be a downturn in investor activism in the EMEA region, we expect that activist investors will continue to play a large role into 2024 and beyond. While interest rates remain high globally, inflation has begun to normalize and optimism surrounding a soft landing has continued to grow in many countries. If interest rates do begin to fall, the availability of capital combined with the relatively poor performance of many stocks over the past few years create the ideal conditions for activist investors to target perceived undervaluation or mismanagement—it would be unsurprising to see an uptick in activist activity in the coming years. In other words: activism remains as relevant a topic as ever.

While no public company or sector is off-limits to activist investors, several have recently drawn increased attention. The industrial, healthcare, and consumer cyclical sectors have continued to draw attention from activists at levels close to or above 2022 while financial services remain the core area that activists choose to target.

In terms of the demands made by activist investors, the data are clear: governance-related issues remain the most targeted, accounting for over half of all demands made by activists in 2023. M&A-

[1] data in this paper is sourced from Diligent Market Intelligence.

related activism decreased in H1 2023, however due to the high-profile nature of the cases it remains one of the primary points of interest for many investors.

Environmental-related demands have steadily increased in over the past few years, which is unsurprising given the surge in popularity of sustainability across the corporate and financial worlds. However, environmental-related activism is often highly specific to the unique circumstances of the company targeted. For this reason, this paper will focus specifically on **Governance** and **M&A-related activist campaigns.** These types of campaigns are two important touchstones of activist investing that every issuer should be aware of. In the following sections, we will examine the trends in activism demands as well as highlight what issuers may expect when an investor launches an activist campaign.

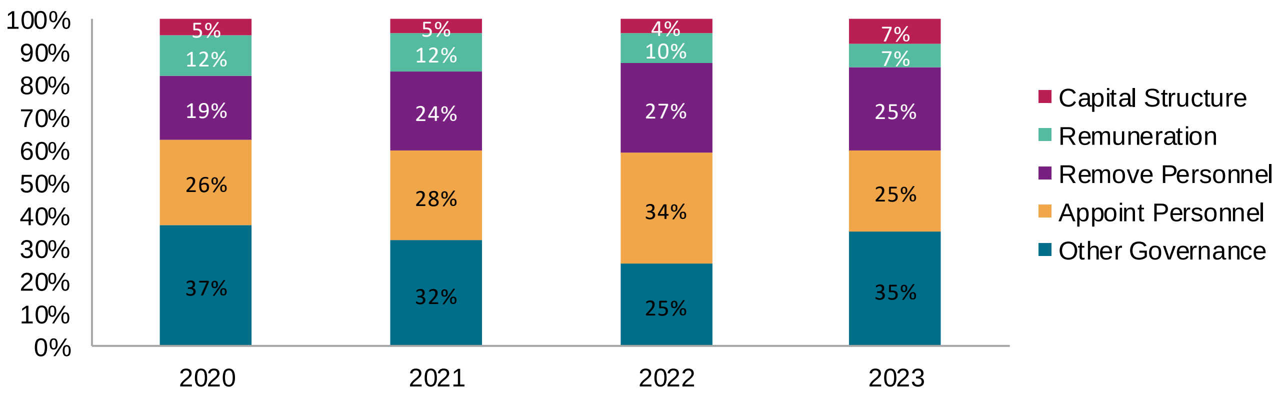
Governance-Related Activism

Governance Breakdown

Why is governance the most cited activist demand? Understanding this requires a further breakdown of what activists are truly trying to achieve in this category. Breaking down the governance demands of activists further shows that the primary focus **remains on the board**. Activist demands to either appoint or remove personnel made up over 50% of the total governance-related demands in three of the four years reflected in the data, with a particularly large spike in 2022, where they reached 61 percent. Board representation gives the activist a window into the operation and oversight of a company so they can ensure that their priorities are implemented and exercise more direct control.

Following board-related issues, remuneration and capital structure issues are often cited by activists. They are important issues for activist arguments emphasizing the need for efficiency and shareholder rights. Capital structure as a category includes requests or opposition for issuances, restructuring debt, and stock splits. These can have substantial impacts on the balance sheet and financial health of any company. The last category, 'other governance,' encompasses a wide breadth of priorities such as disclosing information, amending company policies, replacing auditors, and more.

Activist Demand Split - Governance



In Practice

What can IR departments and boards expect when an activist buys into a company and starts making waves related to governance? While the strategies employed in activist campaigns are often highly specific to both the individual activist investor and the company being invested in, there are some clear patterns to identify.

In general companies can expect **increasing public scrutiny**. Depending on the profile of the activist, company, and holding size, even the act of an activist buying into a share structure can already make waves. While some activists are friendly and keep their communication mostly internal, many post public demand letters to increase pressure on the board to act. Letters may detail poor financial results, inefficiencies, governance failings, or list poor past AGM vote results. For example, high remuneration that is not adequately tied to performance is often cited to paint management as out of touch, wasteful, or decadent.

With the public scrutiny will come more **investor engagement.** Stewardship departments at large institutional investors prioritize engagement meetings with companies with high profile concerns, and activist campaigns typically qualify as such. Furthermore, it is a common tactic of activist investors to attempt to build coalitions with larger institutional investors, meaning that the stewardship department and portfolio managers at these institutions may have already received a PowerPoint deck detailing the finer points of the activist's critique. Such decks often list additional governance-related critiques that they know stewardship departments are sensitive to. Investors may seek to engage with the target company if they share the activist's concerns or if they want to get the other side of the story. However, sometimes investors with smaller positions may simply defer to their stewardship and governance policies rather than devote special attention to the issue. If the activist highlights governance concerns that those smaller investors agree with, they may simply take the side of the activist without further engagement. **This highlights the need for robust and ongoing engagement from the side of the company.**

Of course, this scrutiny and engagement will not be ignored by investors looking to profit from volatility. Personnel-related demands, for example, usually have significant impacts on the market's perception of the future trajectory of the target company—particularly if they are even partially successful. Calling an EGM to replace members of the board or management team raises substantial concerns. IR departments and boards **should be prepared for increased short interest in the company as well as fluctuating share prices.** Short interest and decreasing share prices can have significant knock-on effects including increased costs of capital via issuances and borrowing, general shareholder dissatisfaction reflected at the AGM, reducing employee share-based compensation, and more.

M&A-Related Activism

Shareholder Activism during Public M&A Transactions in EMEA

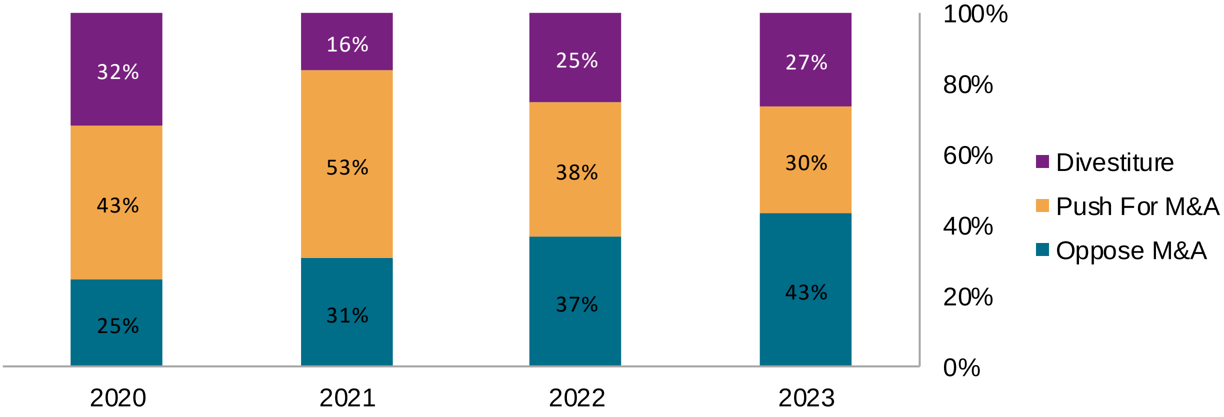
While governance remains the top issue in terms of the quantity of activism demands, M&A-related campaigns are often some of the most high-profile. Shareholder activism is a growing force in the EMEA M&A market. Activists are targeting public companies in the region and are playing a significant role in shaping the outcome of M&A transactions. Activists can help to ensure that shareholders are getting a fair deal and pressure management to improve the company's performance and create value for shareholders over time. However, shareholder activism can also be disruptive and can delay or even derail M&A transactions. Activists may build a significant stake in the target company and demand changes to the terms of the transaction or even oppose it altogether. This can make it difficult for the parties to reach an agreement and can also lead to increased uncertainty and volatility for shareholders.

In recent years, there have been several high-profile shareholder activist campaigns in the region. Some of the most notable include:

1. Elliott Management's campaign against SoftBank Group's acquisition of Arm (value: $66 billion)
2. Cevian Capital's campaign against Novartis' spin-off of Alcon (value: $38 billion)
3. Elliott Management's campaign against GlaxoSmithKline's spin-off of its consumer healthcare division (value: $33 billion)
4. Cevian Capital's campaign against Ericsson's sale of its cloud communications business (value: $6.2 billion)
5. Elliott Management's campaign against AkzoNobel's acquisition of Tikkurila (value: $2.8 billion)

The volume of M&A-related activism overall, involving either pushing for or opposing transactions, has declined since the record levels in 2021. This is in line with the broader slowdown in M&A activity in the region. However, our analysis highlights a notable shift in the behavior of activist investors during M&A transactions. The level of opposition towards M&A deals has been on the rise since early 2020.

Demand Split - M&A



In Practice

It is important for issuers to be aware of what these demands look like in practice. Some of the arguments that can be expected by activist investors for opposing M&A deals include:

Undervaluation Concerns - Low Tolerance for Opportunistic Takeovers: Activists may believe that the proposed deal undervalues the target company. They may build a large position in the target company or form a coalition with other significant investors and oppose the transaction if they think the offer price is not reflective of the true value of the company's assets, market position, or growth potential.

Lack of Strategic Fit: Activists and significant long-term institutional investors often assess whether the merger aligns with the long-term strategy of the company. If they believe that the merger lacks strategic fit or that it does not contribute meaningfully to the acquirer's business, they may oppose the deal.

Poor Financial Terms: Activists may scrutinize the financial terms of the deal, including the payment structure, timeline, stock ratios, and other financial arrangements. Unfavorable terms, such as a disproportionately large payout to the target company's executives, can lead to opposition.

Impact on Stock Price: Investors closely monitor the impact of M&A announcements on stock prices. If they believe that the deal is likely to lead to a significant drop in the acquirer's stock price, they might oppose the transaction to protect shareholder value. Some hedge funds may deploy multiple strategies to take advantage of share price fluctuations post announcement of deals. This could have a negative impact on the outcome of tender offers or vote in case of scheme of arrangements.

Alternative Strategic Initiatives: Activists may propose alternative strategies or initiatives that they believe will create more value for shareholders than M&A transactions. For example, they often advocate for companies to break up or divestiture, sell off non-core assets and subsidiaries or spin off divisions when they believe that the company's overall value can be enhanced by restructuring or focusing on core business segments. This strategy is also pursued when activists identify inefficiencies, underperformance, or mismanagement within the company, leading to a depressed share price.

Opportunistic Approaches: Hedge funds occasionally deploy a speculative trading strategy if they anticipate a takeover bid where they buy shares of the target company in anticipation of a higher acquisition price. The approach relies on the expectation that the acquiring company will pay a premium over the current market price to secure the acquisition. Investors engaging in this strategy aim to profit from the price difference between the current market value and the higher acquisition offer. However, this strategy carries the risk that the takeover offer may not actually materialize, leading to potential losses for investors if the stock price falls back to its original level.

In some takeover situations, investors may seek to build positions in the target company large enough to prevent the offer from reaching the key milestones, such as the delisting threshold or the threshold required for a compulsory acquisition also known as “squeeze out”. These investors hope that reaching these milestones will be important enough to the bidder to get them to offer more favorable offer terms to convince the holdouts. If the offer price increases, the investor profits from their increased stake.

Regulatory or Political Risks: Deals involving companies in the EMEA region often face complex regulatory and political challenges. Activists may oppose a deal if they perceive these risks to be too high, leading to potential extensive delays, fines, or other adverse consequences.

Concerns about Integration: Activists and other active owners may oppose a deal if they have concerns about the practicality of integrating the two companies successfully. Integration challenges, cultural differences, potential disruptions in business operations or even the bidder’s poor history in business integration might lead to opposition.

Governance and Shareholder Rights: Activists and influential proxy advisory firms increasingly take corporate governance issues and the protection of shareholder rights into consideration when it comes to M&A transactions that are implemented via a shareholder vote, such as Schemes of Arrangement. If they perceive that the deal structure undermines shareholder interests, dilutes ownership, or concentrates power excessively, they may oppose the merger.

Sustainability Concerns: Investors may also consider Social and Environmental factors. If they believe that the deal might compromise the company's commitments or reputation, they might oppose it on ethical grounds.

Activist opposition can lead to renegotiations, improved terms, or even the abandonment of deals, depending on the strength of their arguments and the level of support they garner from other shareholders. We have also recently witnessed multiple activists team up against takeover bids in Europe. Companies and their advisors are now increasingly wary of the potential risks associated with shareholder activism during their M&A transactions. As part of standard practice, deal teams must carefully prepare for dealing with activist shareholders should they decide to buy in.

Conclusion

While the overall number of activist campaigns has somewhat decreased in EMEA, activist investors continue to play an important role in driving change, opening discussions, and shaping norms in the region. No sector is off limits and activist investors are increasingly turning to new markets in order to launch campaigns and generate returns.

Managing activist investors requires a delicate balance of responding to their demands, implementing business priorities and, crucially, managing the perceptions of shareholders and proxy advisors. As always, prevention is the best medicine. Given that corporate governance is such a significant concern for activist investors, it is vital to proactively assess and improve governance standards before activists buy in and start drawing significant attention. Governance expectations frequently change, so some of the best-prepared companies have yearly governance reviews, open lines of communication with their investors' stewardship departments, and watchful eyes on their AGM results. Dissent on resolutions should already be considered a potential red flag for an activist investor to take advantage of.

Whether for governance or M&A, it is vital to have the right supporting team to aid in communication and shore up any potential weaknesses in company strategy should an activist buy in. Securing support from key investors might very well make the difference in a contentious vote. Bringing in an experienced activist management firm with robust governance expertise can help snip several avenues of activist critique in the bud and ideally position companies to weather the storm.

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