Q&A with Latham & Watkins partners Mark Gerstein, Tim FitzSimons, Tony Richmond and Steven Stokdyk, and Chris Young, Managing Director, Head of Contested Situations at Credit Suisse

Activism: Every Season is Now Open Season

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Activism has become omnipresent and now targets virtually every industry sector regardless of a company's size. The number of campaigns are up, the amount of capital allocated to activism is at an all-time high and activists are becoming increasingly aggressive. The asset class has matured and the lines are blurring between activists and private equity, strategic bidders and mainstream investors.

In this lw.com interview, Latham & Watkins partners Mark Gerstein, Tim FitzSimons, Tony Richmond and Steven Stokdyk, and Chris Young, Managing Director, Head of Contested Situations at Credit Suisse, discuss the ways in which activists' tactics and timing are changing and how financial advisors, management and boards can prepare in advance of an activist knocking on a company's door.

How should companies prepare for activism in advance of a fight?

Stokdyk: There has been an explosion in the number of activist investors. Because there are so many activist investors and the volume of their campaigns has gotten so large, their tactics and objectives have become as equally broad. These activists tailor their tactics to each company's situation, whether it is a very public or private campaign.

Richmond: There is no better preparation than having a good sense of what your shareholders expect of you, and regularly communicating what you are trying to achieve to your shareholder base. It has been my experience that when an activist first surfaces, the board will express that the company's shareholders love them. But there may be a situation where the shareholders have been trying for a long time to tell the board to change, but the board wouldn't listen, and the shareholders throw their support behind the activist.

Companies should undertake a rigorous review of weakness relative to ISS recommendations and Quickscore. The board should regularly consider its strategic alternatives and the associated financial implications and broader financial projections; clearly define overall leadership and allocation of responsibilities in advance; and develop, in conjunction with management, "stop-look-listen" materials as an initial response.

How are activist tactics changing and evolving?

Gerstein: Historically a number of activists seem to have worked from the same playbook in approaching companies. However we are seeing a number of new modified strategies, including timing. Until very recently, activism focused on using the threat of a fight at the annual meeting as leverage to accomplish the activist's goal. We are now seeing proposals of upcoming activism initiated after the window for nominations has come or even within a month or two after the annual meeting.

What is driving this change in tactics?

Young: I think this change in tactics comes down to a couple of things. One is that the capital is more permanent or semi-permanent at these funds than it was say 10 years ago. Many restructured their funds after 2008; some are permanent capital vehicles so they have the ability to be more patient.

The other thing is that activist investors look at their portfolio, which is highly concentrated typically, and they put the targets into different buckets. Bucket number one might be a high degree of urgency, an inflection point at the company where the activist is really going to want to influence events as soon as possible. If that is the case, activists are going to want to time it correctly. An activist is not going to want to miss that window and be out there without any sort of stick to use against the company. Other targets may be put into different buckets with no immediate sense of urgency – where the activist's runway can be longer.

Some of the more seasoned activists are taking a multi-month approach of private dialog with the company and are trying privately to convince the company of the need for a change in operations or strategy because the activist may generally prefer to avoid the expense of a proxy fight or may be seeking to cultivate a brand as a “reasonable” activist. That type of activist investor may look for a meeting with senior management and a subset of the board and/or ask for site visits, and that scheduling can take multiple months. Many of these activists are willing to give the company a chance to see what it can do before it must make a decision regarding whether to seek to add directors to the board.

If the activist can get what it wants without having to run a full-fledged fight ─ they’ve got the full-fledged fight already going on in the first bucket I mentioned ─ that is great for them because they’ve got limited resources. It’s my impression that they don’t mind a slower pace. And they’ve got more permanent capital, so they can be more patient. Ultimately, the elephant in the room in all of these private meetings is the activist’s ability to escalate at any time, turn over the shareholder base into more short-term funds, and make it a more acrimonious situation.

How can financial advisors partner with a company’s board on an ongoing basis?

FitzSimons: Financial advisors play an important role even before an activist is at a company’s doorstep. Perhaps the best “defense” to an activist is when the board has previously considered the strategy that the activist is recommending. Financial advisors can provide significant value to boards by raising the types of things an activist might object to or suggest ─ the board can be thinking about it in advance with the benefit of expert financial advice. This puts the board in a better position to have a well thought out response and articulate why an idea might be inappropriate at the current time or in the future, or appropriate within a certain time horizon. Having a financial advisor partner with a company and its board to do that hard work in advance really puts a company in a great position to respond.

Young: Management can lose credibility when the board hears ideas for the first time from an activist rather than from the management team. In my experience, the board will be confident in management’s credibility if it understands the potential vulnerabilities and has hired advisors to understand where the company is vulnerable and where the vulnerabilities can be closed in a way that’s shareholder friendly. And we all know that activists are trying to drive a wedge between management and the board.

Are companies more frequently choosing to settle and grant board seats to activists?

Richmond: With some frequency, we are seeing activists ask for board seats and the establishment of a committee that would look at, manage or drive a process that directly relates to an area of interest to the activist’s agenda. These requests can be challenging because they tend to split the board.

FitzSimons: How the board changes depends on who those new directors are. If it is an activist with an agenda they are going to push regardless of the board’s opposition — it is tough to integrate those directors fully into the operations of the board. Other activists are content to place experienced, independent and thoughtful directors on the board. These are the types of directors boards should be on the lookout for anyway and can be integrated far more easily.

In addition to golden leashes and disclosure of how a director’s interests might differ from the rest of the board, boards should be thinking about confidentiality policies — just to ensure that everybody on the board is aware that what’s said in the boardroom about company business remains there. We’ve also found that companies like communications policies or strategies that make clear who can speak for the board. This is to prevent an activist from getting out in front of the board or company, making statements that are then attributed to or are purported to come from the company itself.

For More Information

Listen to Mark Gerstein, Tim FitzSimons, Tony Richmond and Steve Stokdyk, lawyers from Latham’s Mergers & Acquisitions and Public Company Representation Practices, review the latest shareholder activists’ strategies and the most effective means for companies to anticipate and address those tactics along with Chris Young of Credit Suisse. The recording of “Activism: Every Season is Now Open Season” will be available until October 8, 2015 at 10:30 AM Pacific Daylight Time.

Download the “Activist Hot List.”

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