ACTIVIST INVESTORS IN EUROPE: WHO WILL THEY TARGET NEXT?

FORECAST AND OUTLOOK FOR 2020

A&M ACTIVIST ALERT (AAA) – DECEMBER 2019 UPDATE

ALVAREZ & MARSAL

Contents

Foreword

Clear and present danger

Publicly listed companies in Europe ignore activist investors at their peril. Once targeted by an activist, senior management and the board will find themselves expending significant time and money, considering issues that they hadn't (but should have). They will also certainly be distracted from their all-important day-to-day business activities. As a result, the companies and their own professional reputations will be put at risk.

Strategic change, divestment, as well as board and management changes are all likely outcomes. But the most significant is often change of control. Indeed, in independent but complementary work conducted by Cass Business School, we found that 23 percent of companies targeted by activists were ultimately acquired by another firm, against a 4.3 percent likelihood over the same period of any public company becoming an acquisition target. We also found that when a company announces an acquisition which is followed by activists taking a position in the deal, the completion rate of those deals is only 33 percent. This compares very poorly to the overall 89 percent completion rate of announced deals.

Then, it is no surprise that there should be great value in Alvarez & Marsal's Activist Alert (AAA), which identifies through its predictive algorithm, European companies that are more likely than not to be targeted. Now in its third year, this report raises some critical issues that should be front-of-mind for the C-suite and board members of any public company in Europe.

Notably, for the first time this latest update explores the impact that poor ratings across wider environmental, social and governance (ESG) factors can have in driving activist targeting. The growing scrutiny of ESG factors when it comes to corporates, parallels the immense increase in attention by politicians and the public in Europe on issues such as climate change.

As with stock market and deal activity, the largest markets in Europe naturally show the greatest activist activity, with sectors such as tech seeing growing activist attention. The AAA goes beyond those leading countries and sectors, however, as no public company in any country in Europe is immune to the rise in corporate activism.

Tom Clancy's 1989 novel, 'Clear and Present Danger' was prescient in predicting the ability of small non-state actors to threaten superpower nations. This is despite all the signals being in place for many years, but having been ignored by expert advisors at the highest levels. Listed companies in Europe would do well to remember that lesson when reading this report: activist investors may only take small stakes in companies, but their impact can be massive.

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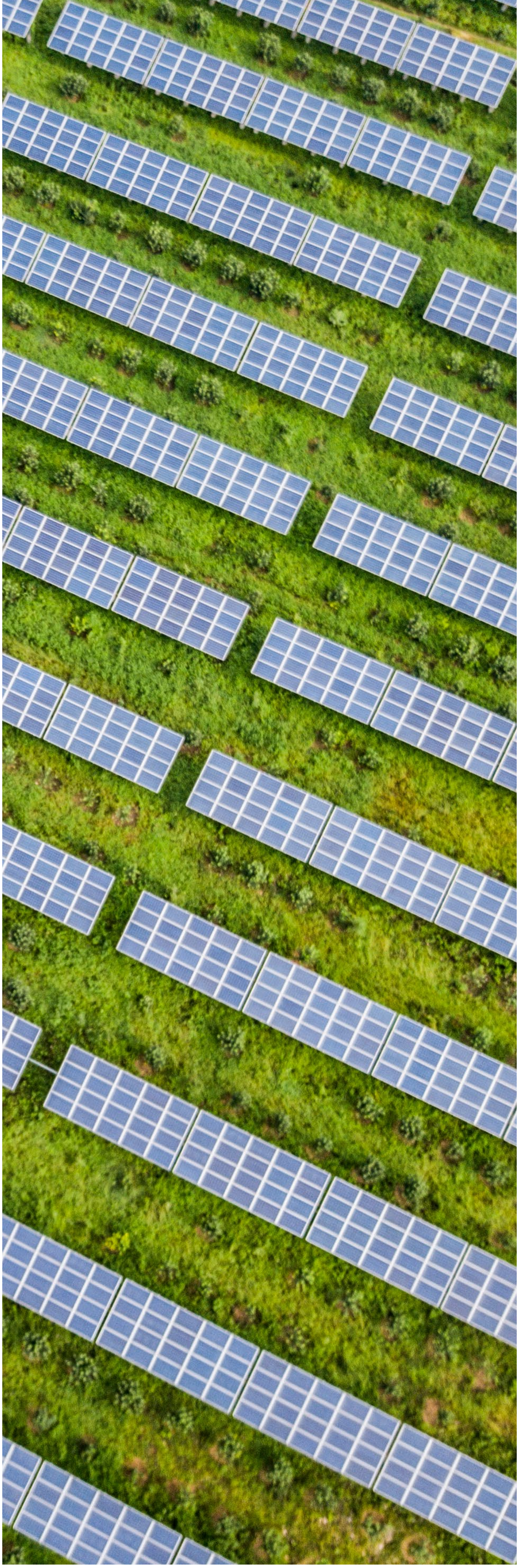


Executive summary

Principal observations

Activist investors are increasing their focus on Continental Europe and the latest Alvarez & Marsal Activist Alert (AAA) indicates that 2020 will see them push the boundaries of what constitutes a likely target further still. Our analysis, which identifies companies across Western Europe at risk of becoming public targets for activist investors, highlights a growing number of "at-risk" groups, particularly in the technology sector, alongside a continuing focus on industrial companies. We also expect activism to increase further in Continental Europe, especially in France and Germany, as activist investors continue to push the boundaries of what constitutes a potential target.

Our AAA report, now in its fifth edition, demonstrates for the first time the increasing importance of wider environmental, social and governance ("ESG") issues for activist investors. Whilst corporate governance has long been a focus for investors, and has been included in our AAA analysis from the outset, wider environmental and social factors are fast becoming mainstream concerns among institutional investors. Our analysis identifies a compelling link between companies' wider ESG ratings and their likelihood of becoming targets for activist investors. Our analysis shows that companies ranked in the bottom 50 percent on ESG performance are significantly more likely to attract activists' attention.

These findings have wide implications. They indicate that ESG ratings, in conjunction with other factors, can act as a significant predictor of potential activist interest. This makes sense, given the growing body of research that demonstrates a persistent correlation between companies that score well on ESG measures and those that generate superior financial returns.

Summary outlook for 2020

As the importance of ESG increases among the wider institutional community, supported by high-profile endorsements by figures such as Larry Fink, Chief Executive of BlackRock, we believe ESG will inevitably become an increasingly important consideration for activists. The logic is simple: to gain traction, activist campaigns must generate support from the target's wider shareholder base. The more these institutions focus on ESG issues, the more this will turn ESG into a meaningful lever for activists looking to engage others in their campaigns.

JANA Partners, the U.S.-based manager that has been planning a socially responsible activist fund since last year, exemplifies this trend. Jana has a history of collaborating with mainstream institutions and last year, in partnership with the California State Teachers Retirement System (CalSTRS), successfully pushed Apple to do more to address smartphone addiction among children. And in our own advisory work, we have noted activists shying away from ESG sensitive stocks (e.g. tobacco).

The significant interplay between ESG and shareholder activism that we have identified suggests that the wave of activism across Continental Europe will continue to build.

This is borne out by our updated analysis. Since our last report in April, there has been a significant increase in the number of potential targets the AAA has identified in France and Germany, as well as in Spain (though the latter starts from a lower base).

The U.K. remains the largest market for activists, but its dominance is eroding as they increasingly adapt their tactics to Continental Europe.

In this context, we believe Elliott Management's decision to target Pernod Ricard, the French drinks group dominated by its founding family, may well come to be regarded as a watershed for activism on the Continent.

The 30 percent appreciation in Pernod Ricard's share price in the months following Elliott's disclosure of a 2.5 percent stake indicates wide market support for this attempt to encourage change, and therefore represents a striking success against what might have been perceived as a particularly challenging target. The subsequent investment by Third Point in EssilorLuxottica, another large and tightly held group, highlights the growing willingness of global activists to keep pushing the boundaries of what constitutes a likely target.

In sectoral terms, industrials remain a significant target but interest in consumer companies continues to decline. Since April's AAA update, we have seen a marked increase in the number of potential targets in the tech sector, following recent campaigns in the U.K. (JustEat) and Germany (Scout24). Interest in tech companies may well increase further if, as suggested by some recent reports, European stock exchanges consider relaxing their rules on dual class share structures – a common feature among U.S.-listed tech companies – to attract more international listings.

OUTLOOK FOR 2020

- Continental Europe – activism will continue to grow
- ESG Ratings -a meaningful predictor of potential activism
- Industrial companies – biggest target group
- Tech companies – growing focus for activists
- Breaking boundaries – activists continuing to adapt their approach and tactics

Activism in the news

Successive waves of research for the six-monthly refreshed AAA analysis have highlighted a growing trend among activists to push the boards of underperforming companies to unlock value via M&A activity. In both 2017 and 2018, around 12 percent of activist interventions called for M&A: that has now risen to 18 percent in 2019, up to the end of October. Whether the underlying driver is sub-optimal capital allocation, a lack of strategic focus or deepening share price discounts applied to conglomerates, calls for M&A featured prominently in recent campaigns against companies that our analysis predicted would become targets.

Due to our confidentiality guidelines, we do not publish the individual names of companies our forecast identifies as potential activist targets (i.e. prior to any announcement). However, since April public campaigns have begun against Ferguson, Imperial Brands and Domino's Pizza in the U.K., Altran Technologies (France), OSRAM Licht (Germany) and Spain's Grupo Codere and Parques Reunidos – all of which were on our list of predicted targets.

Under pressure from Trian Fund Management, founded by U.S. investor Nelson Peltz, plumbing products company Ferguson announced a demerge of the U.K. from its larger U.S. business in September and said it was considering a U.S. listing.

Corporate restructuring also featured prominently at Domino's Pizza, where U.S. activist Browning West disclosed a 5.33 percent stake in October. The company faces mounting pressure for management changes, having already put its loss-making international operations up for sale.

High profile cases in France (Altran Technologies), Germany (OSRAM Licht) and Spain (Parques Reunidos) saw shareholders opposing takeover deals that they argue undervalue the companies. In the case of Osram, it is striking that resistance to a €3.4bn private equity takeover was led by Allianz Global Investors, an institution not known for public displays of activism. But Allianz was far from alone among traditional institutions in employing activist tactics against boards it disagreed with. In the U.K., tobacco company Imperial Brands came under pressure from institutional shareholders and in October its CEO, Alison Cooper, announced her planned departure as and when a suitable replacement could be found.

Boards can no longer safely assume that investor activism is confined to specialist players – traditional long-only asset managers are becoming increasingly active.

The red and amber lists: who are the activists' next targets?

Our latest analysis flags 158 companies that are at significant risk of becoming activist targets. In the data we publish, we do not disclose the names of the companies we identify as being "at-risk", although the country and sector trends are included.

Of the 150 companies we identified in our April 2019 report as being at risk over the next 18 months, 33 have already been publicly targeted by activist investors.

What do red and amber warnings mean?

A **red** warning indicates that a company is likely to become a target within the next 6-12 months. An **amber** warning signals a medium-term risk of becoming a target within 12-18 months.

On the following pages, we summarise and illustrate comparative data from our twice-yearly analysis of the number of companies at risk of activist approaches across countries and sectors.

You can view full previous reports at:
www.alvarezandmarsal.com/insights/am-activist-alert

Number of predicted activist targets: changing profiles since April 2019 report

Countries (as at 30 September 2019)**:**

24 ▲	**U.K.** Total: **54** ▲	30 ▲
11 ▲	**Germany** Total: **25** ▲	14 —
11 ▲	**France** Total: **24** ▲	13 ▲
6 —	**Scandinavia** Total: **15** ▲	9 ▲
5 ▼	**Benelux** Total: **11** ▼	6 ▼
5 —	**Switzerland** Total: **11** —	6 —
5 —	**Italy** Total: **11** —	6 —
3 —	**Spain** Total: **7** ▲	4 ▲
Total: 70 ▲	**Total: 158** ▲	**Total: 88** ▲

Sectors (as at 30 September 2019)**:**

23 —	**Industrial** Total: **52** ▲	29 ▲
12 —	**Consumer** Total: **32** ▼	20 ▼
12 ▲	**Technology** Total: **24** ▲	12 ▲
7 ▲	**Healthcare** Total: **14** ▲	7 ▲
5 —	**Materials** Total: **11** —	6 —
3 —	**Communications** Total: **7** ▲	4 ▲
3 ▲	**Energy** Total: **7** ▲	4 ▲
5 —	**Other** Total: **11** —	6 —
Total: 70 ▲	**Total: 158** ▲	**Total: 88** ▲

Indicators showing change compared to our April 2019 report ▲ ▼ —


Equity value and structure
Country
Assets and Liabilities
Timescales
Sectoral
Profitability
ESG

Forecast and outlook for 2020

What are activists' priorities?

The AAA model analyses changes over time in 45 variables broadly grouped under the following headings:

- Country
- Sectoral
- Environment, Social and Governance ("ESG")
- Profitability
- Assets & liabilities
- Equity value & structure

In this report we have focused on the Country, Sectoral and ESG groupings.

Whilst we have analysed the impact of governance, notably boardroom diversity and dynamics, in previous AAA updates, in this report, we have for the first time included wider ESG ratings in our analysis and demonstrate a meaningful link between poor ESG ratings and a heightened risk of activist approaches. We detail our ESG analysis in an extended section, alongside developments in activists' focus on individual countries and sectors as the areas that have seen the most change since our April report.

Our results show that once companies start to underperform, on average they have 1.86 years before activists intervene. Given that remedial actions can take up to a year to show results, boards have a narrow window in which to make changes – and demonstrate bottom-line results – before the risk of being targeted starts to turn into reality.

Country

The spread of investor activism across Continental Europe is gathering momentum. Our forecast indicates that companies in France and Germany are likely to attract much greater attention from activist investors, along with Spain, although the latter starts from a much lower base. The number of German companies with red or amber at risk ratings reached 25 this time, up from 16 in September 2017, when we published our first AAA, and 23 in April this year. Similarly, the number of French companies at risk has jumped to 24, up from 20 in April.

We believe this shift reflects the recent success of activist investors in adapting their methods to Continental European markets. The sharp rise in Pernod-Ricard's share price in the months after Elliott Management launched its campaign against the drinks company reinforces our conviction.

We also note the growing willingness among mainstream institutions to support or even adopt the approach of activists and make their disagreements with company boards public.

The U.K. remains the favourite European market for activists and is forecast to remain so

This is particularly marked in Germany, where the number of significant protest votes at companies' annual meetings more than doubled year-on-year in 2019. Taken together, these developments show that the activist genie is firmly out of the bottle in Continental Europe.

Despite this, the U.K. remains the favourite European market for activists, with 34 percent of all companies at risk, despite accounting for just over a quarter of the companies in our data set. However, its relative attractiveness for activists has weakened considerably since April as the number of vulnerable companies in other territories has gone up.

Sectoral

Industrial companies remain the largest target in sectoral terms, with Germany's overweight position in this sector helping to explain its rising appeal for activists – the country is home to 14 percent of the companies in our data set but makes up 19 percent of the industrial sector companies. However, our latest analysis shows activist attention is forecast to shift further towards other sectors including technology and healthcare.

The number of tech companies at risk of activist approaches has climbed to 24 (21 in April 2019). Campaigns against JustEat in the U.K. and Germany's Scout24 reinforce the trend we highlighted in our last report: tech companies that disappoint on product, profitability or otherwise driving shareholder value offer attractive targets for activists because they typically trade on higher earnings multiples than other sectors. This means that every pound or euro of additional profit unlocked should translate into larger share price gains than one would expect in less highly rated sectors.

We also believe that any move to attract more international listings to European exchanges by relaxing restrictions on dual class share structures would, if successful, increase the number of potential European targets in the tech sector.

As noted above, calls for companies across all sectors to address underperformance through M&A activity continue to grow. Recent examples include Ferguson and Cobham in the U.K. and Scout24 in Germany, which follow earlier cases including ThyssenKrupp, Akzo Nobel and Whitbread. Capital allocation policies and divisional Return on Invested Capital (ROIC) will continue to be a focus for activists, and those conglomerates that underperform will face increasing pressure to take radical action.

The major exception to the rise in shareholder activism is the consumer sector, which faces ongoing digital disruption. Here, the number of companies predicted to become targets has fallen from 35 in April to 32 and although this sector accounts for a quarter of the companies in our data set, we expect it to fall further out of favour with activists. The recent Alvarez & Marsal report, The Shape of Retail, in partnership with Retail Economics, highlights the type of pressure consumer companies face. Between 2010 and 2018, it found that profit margins in physical stores collapsed by half and overcapacity reached 20 percent.

Given that activists generally target good companies that can be improved and avoid those facing existential threats, we expect their focus on the consumer sector to shrink further.

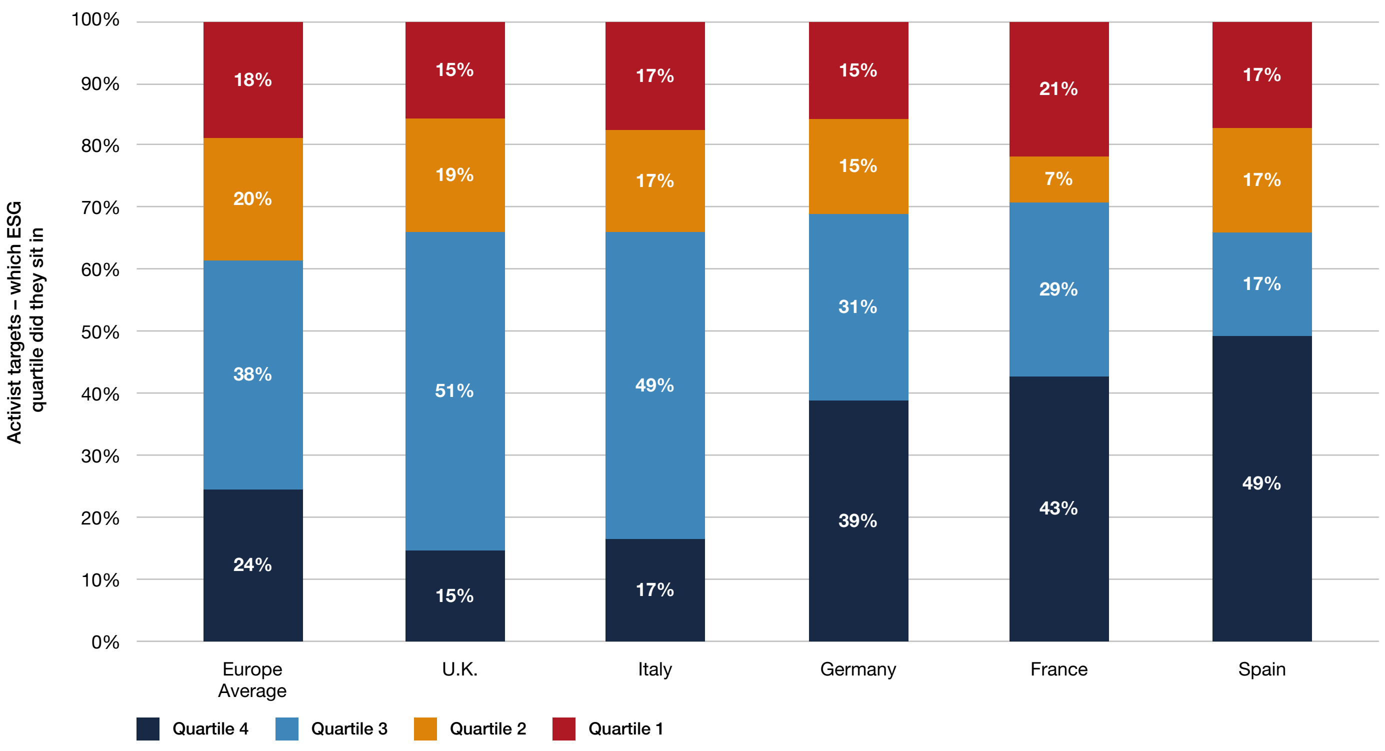
The number of tech companies at risk of activist approaches has climbed to 24

Industrials, Tech and Healthcare are forecast to grow as target sectors. Consumer continues to fall away.

Environmental, Social and Governance

Previous rounds of analysis for the AAA have incorporated governance factors including boardroom diversity in terms of both gender mix and age range. However, in view of the growing importance of ESG ratings to institutional investors, we have incorporated a broader consideration of ESG factors into our analysis for the first time to assess their relevance for activist investors. The results demonstrate that poor ESG ratings, in conjunction with other factors, are significant in predicting which companies are likely to be targeted by activists.

Composition by ESG ratings quartiles of European companies targeted by activists since 2017



Activist Targeting by ESG Quartile

Our findings used ESG ratings from Refinitiv for circa 1,300 European corporates. Having ranked these corporates into four quartiles based on their ESG scores, we then analysed how many in each quartile had been the subject of activist campaigns since 2017. To provide further insights, we also highlighted European markets of particular interest in a country breakdown. Across Europe, over 60 percent of companies targeted were in the lower two ESG quartiles. This provides meaningful evidence that poor or deteriorating ESG scores are an early warning sign that a company is more likely to come under pressure from new or existing investors.

This correlation makes sense, given the growing body of research indicating high ESG ratings are associated with superior financial performance. Low-scoring companies are therefore likely to have the potential to improve their financial performance, making them natural subjects of the activists' attention. However, our analysis turned up some major differences between countries over which of the lower two quartiles was more likely to contain activist targets.

In the U.K. and Italy, companies with quartile-three ESG scores are much more likely to be targeted than those in quartile four, the lowest-ranked group. In fact, simply being in quartile three roughly doubles the probability that a U.K. or Italian company will become the target of an activist campaign, compared with the cohort overall. In Spain, by contrast, the opposite is true. Half of all Spanish companies targeted are in the bottom quartile – again, falling into this group doubles the probability of an activist approach.

One possible explanation for this divergence lies in the differing levels of adoption of ESG investment practices between countries in Europe. A 2018 report by the European Sustainable Investment Forum found the U.K. and Italy had the highest proportion of funds pursuing active engagement on ESG issues and excluding companies with low ESG scores, while Spain had the lowest proportion[1]. Our initial conclusion is that because activists need to engage other investors in their campaigns to have the greatest chance of success, the more institutional investors in a market exclude companies with low ESG scores, the less attractive these low-scoring companies become to activists. This could explain why relatively few quartile-four companies in the U.K. and Italy are targeted by activists, while a large number of those in Spain continue to be.

Ultimately, our analysis of ESG performance shows that ESG is becoming an increasingly important consideration for activist investors – just as it is for mainstream institutions and the public at large. With 62 percent of activist targets across Europe since 2017 falling into the bottom two ESG quartiles, the message is stark: companies in these groups are on average 24 percent more likely to find themselves fending off an activist campaign.

Over 60 percent of companies targeted were in the lower two ESG quartiles

1 The report by the European Sustainable Investment Forum included an analysis by country of the funds dedicated to sustainable investment. Two notable investment practices adopted across Europe were (i) Active Engagement and Voting on Sustainable/ESG issues and (ii) Exclusions (i.e. avoiding corporates with lower sustainability/ESG profiles). The funds dedicated to these two investment practices in the five countries the AAA examined were highest in the U.K., followed by Italy, Germany, France and then Spain (with only 4 percent of the dedicated funds compared to the U.K.).

Methodology

Companies covered by the analysis

A&M's Activist Alert model is based on an extensive and rigorous analysis of activist activity in eight European countries and regions from 1 January 2015 to 30 September 2019. The latest analysis includes the U.K., Germany, France, Scandinavia, Switzerland, Benelux, Italy and Spain. We gather data via the A&M Global Insight Centre on corporates listed and headquartered in those countries or regions with a market capitalisation of $200 million or more.

Our research team analysed 204 situations in which activist investors had made public requests to company boards, an increase from 181 in the April 2019 report. We then compared those 204 publicly targeted companies with 1,393 corporates which had not experienced such activist campaigns.

We have focused solely on public campaigns because we cannot track private discussions between boards and activist shareholders in a robust and consistent way. In addition, private campaigns do not bring a high level of financial and reputational risk to the target company associated with public campaigns.

What we measure

In order to provide a forecasting model and associated scoring system to gauge the likelihood of a company being targeted by activist investors, we analyse each company using 45 quantitative and qualitative variables derived from publicly available information. Most of the quantitative variables assess a company's relative performance against sector peers.

The variables analysed can be broadly grouped into the following categories: Country; Sector; Environment, Social and Governance; Profitability; Assets & Liabilities; and Equity Value & Structure. The analysis then enables us to identify key messages and underlying issues that bring heightened awareness to corporates, such as:

- **Key variables –** factors that have the greatest influence on the likelihood of becoming an activist target, and how the corporate rates against all such factors
- **Timescale –** on average how long do activists wait before launching a public campaign?
- **Sectoral –** which industries are currently at most/least risk of public activism, and what are the best companies in those sectors doing to outperform their peers?
- **Geography –** which countries or regions are forecast to be at most/least risk of public activism and why?
- **Evolution –** how is the importance of each of these factors changing over time?

Our predictive model calculates an AAA score for each company on a logarithmic scale between zero (low risk) and one (high risk) and calculates the probability that it will be targeted by activists. Most importantly, it identifies the key steps the company could take to reduce its AAA score and probability of being targeted.

We monitor the success of the AAA in successfully predicting which corporates will have been the subject of a public activist approach over a rolling two-year period. Over the two-and-a-half years to 30 September, 2019, the success rate was 60.3 percent.

A valuable warning system against public activist campaigns

The A&M Activist Alert model is a valuable early warning system against public activist campaigns. Our model produces detailed results showing the actions individual companies should take to improve performance and shareholder returns and so release the hidden value that attracts activists in the first place.

The key factors are different for each business and we work hard to understand what they are and tailor a transformation programme accordingly.

How A&M can help

In predicting and avoiding a public campaign by an activist investor, A&M supports boards during three key stages:

Stage 1: Current position/AAA score

Adopting a focused "outside-in" perspective, we assess how an activist would view the corporate, provide the company's AAA score, predict the probability of public activist action, discuss the key variables driving the company's score and benchmark these variables against sector peers. This can help pre-arm a board against private approaches from activists seeking non-public discussions.

Stage 2: Corporate transformation/route planning

Using these insights, we create a robust transformation programme to deliver measurable benefits in a timeframe that meets investors' expectations. This may include assisting in identifying potential disposals and/or improving underperforming and non-core business units or assets.

Stage 3: Transformation implementation

We work with the board and management to deliver the benefits set out in our transformation programme on time. Our unique restructuring heritage and experience ensures that the transformation is robust and sustainable.

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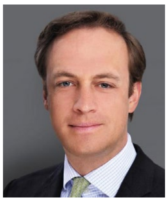

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ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to drive change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

With over 4,000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, help organizations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

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