ACTIVIST INVESTORS IN EUROPE:

WHO WILL THEY TARGET NEXT?

FORECAST AND OUTLOOK FOR 2021

A&M ACTIVIST ALERT (AAA)

ALVAREZ & MARSAL

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Activism slowed in 2020 - however this is a temporary respite and activist forces are building, with a 'crunch time' approaching for underperforming companies.

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Executive summary: Six key themes at a glance

In this sixth edition of the Alvarez & Marsal Activist Alert (AAA), our analysis has identified six core themes that summarise our predictions for investor activism in Europe in 2021.

1. A resetting of the battlefield and an increase in the number of European corporates predicted to be targeted by activist investors

The COVID-19 pandemic has reconfigured the landscape for investor activism across Europe. Companies have seen their operations hugely disrupted and their markets transformed almost overnight; for many, the financial impact has been significant. In the face of this systemic shock, corporate performance has varied markedly.

This has created an attractive hunting ground for activists, highlighting winners and exposing weaker companies that offer activists an identifiable route to increased shareholder value.

As a result, the number of companies predicted to be at risk of becoming public targets for activist investors has increased.

2. Activism has slowed this year – however, this is a temporary respite and activist forces are building, with 'crunch time' approaching for underperforming companies

Although the market turmoil from COVID-19 has undoubtedly created opportunities, public activist campaigns have yet to return to their pre-pandemic levels. 50% fewer new campaigns were launched in Q2 2020 compared with a year earlier, and whilst Q3 saw some pick-up, the number of campaigns was still 30% down for the year-to-date.

We believe most activists are biding their time, conscious of the risk of appearing "tone deaf" to the unfolding public health crisis. Nevertheless, they continue to circle the weaker performers, quietly building non-disclosable stakes and preparing their campaigns.

3. As the wave of activism returns, there will be a greater focus on the U.K.

In the lead-up to the first wave of the pandemic, activism against Continental European targets was growing rapidly as investors became increasingly confident and ambitious in their campaigns.

However, COVID-19 has, to an extent, reset this landscape. While we expect activist interest in Continental European companies to endure, it will be somewhat eclipsed by a renewed focus on U.K. targets in the months ahead.

The crisis has had a serious impact on U.K. corporate performance and given the country's activist-friendly governance and regulatory environment, we expect interest in the U.K. to significantly rebound.

4. Activism campaigns will focus more on the need for operational transformation

A&M analysis of 245 public activist campaigns since 2017 has shown that those that focused on the need for operational transformation generated share price performance that was 3.4% higher than market indices.

This contrasts with campaigns focused on seeking a change in governance which underperformed market indices by 2%.

This clear outperformance combined with the need to fundamentally reassess and restructure corporate operating models will lead to greater demand from activists for operational transformation.

5. Technology and healthcare will join industrials as the most attractive sectors for activists

Whilst industrials are predicted to remain the most targeted sector, the number of targets in technology and healthcare has increased considerably.

We predict that activity in these sectors will intensify, although when it comes to healthcare, activists will need to pick their fights and plan their campaigns carefully given the positive market and public sentiment enjoyed by many companies in that space.

6. Environmental, Social and Governance (ESG) campaigns will become bolder and more common

Corporates will continue to face ever greater pressure to address social and environmental issues. Such pressure has intensified through 2020 with a record number of ESG focused resolutions, and we predict that activist funds will not be shy in building that market sentiment into their campaigns.

In 2020 most activists have been biding their time, conscious of the risk of appearing "tone deaf" to the unfolding public health crisis.

Outlook for 2021 – in more detail

The refreshed AAA model identifies 161 companies that we believe are at significant risk of public activist campaigns, up from 158 at the time of our last report in December 2019.

However, the number of activist campaigns launched so far this year has declined as these investors paused activity to assess the market turmoil.

As we move into 2021 – and despite the continuing effects of the pandemic – we predict that the numbers will rebound as activists return to the public stage and deploy capital in earnest once again. We also forecast more campaigns advocating operational transformation programmes to release greater value from underperforming companies.

In addition to a resurgence of interest in the U.K., the sectoral mix will also change with consumer-focused companies falling further out of favour.

We believe that the COVID-19 disruption to areas such as hospitality, physical retail and travel has left much of the sector too deeply damaged to be of immediate interest to activist investors, who typically focus on underperforming companies that have a clear path to recovery – a good company that can become great is the ideal target.

Instead, we expect more activist campaigns to target industrial, technology and healthcare companies. The number of predicted targets among industrials increased again in this latest analysis and this sector now accounts for 38% of all "at-risk" companies.

Predicted technology-sector targets have also increased after the gap between the strongest and weakest performers widened during the pandemic. Given the potential to generate high returns on capital, we predict increased activist interest in this sector, whose members now make up 18% of all predicted targets.

Healthcare companies are also expected to attract activist attention over their profitability. Although sentiment towards them is generally positive, those companies that have taken this for granted will come under pressure during 2021.

There are strong indications that ESG issues will play an increasingly important role in activist campaigns.

Governance has always been an important consideration for activist investors, but there is ample evidence that environmental and social issues have become much more prominent during the COVID-19 crisis.

These issues are now behind a growing number of campaigns against boards by mainstream institutional investors, including the recent shareholder vote against consumer goods giant Procter & Gamble on environmental grounds. Activist investors will hope to harness these ESG-related trends to build broader support for future campaigns.

The pandemic has hit businesses hard and caused big losses in many institutions' equity portfolios. Although there has been a relative lull in activist campaigns, the COVID-19 disruption means that 2021 is likely to signal "crunch time" for many companies that have underperformed during the crisis.

OUTLOOK FOR 2021

- Resetting of corporate landscape – increased number 'at risk' corporates
- More campaigns – 'crunch time' after a lull in activist activity
- U.K. – resurgence of interest in targets
- Operational transformation – key focus of campaigns
- Industrials, tech and healthcare – in the activist crosshairs
- ESG – becoming an ever greater focus of activism

Activism in the news

Over the past year, companies that the AAA model correctly predicted in December 2019 would become activist targets have included Dominos Pizza Group and Inmarsat plc in the U.K., Bilfinger SE and Hugo Boss AG in Germany, Ontex Group in Belgium, Suez SA in France, and Qiagen NV in the Netherlands.

As already highlighted, the COVID-19 pandemic has sharply reduced the number of new activist campaigns this year. However, activism has not gone away. One high profile example over the summer involved the Swedish activist Cevian Capital, which built a stake of 7 percent in the U.K. educational publisher Pearson and called for outgoing CEO John Fallon's successor to realise the company's "full potential".

Elsewhere, despite the relative lack of new campaigns, some existing ones have heated up. Notable examples include Facebook, which has faced repeated calls for its founder, Mark Zuckerberg, to stand down as chairman over governance concerns. In the U.K., activists led by Coast Capital gained a victory in March after FirstGroup plc announced the sale of its Greyhound intercity bus service in North America.

In May, French media and retail group Lagardère defeated an attempt by the group's biggest shareholder, Amber Capital, to overhaul its boardroom governance by nominating eight new directors. However, this saga continues as Vivendi and latterly Qatar Holdings joined the fray, seeking greater shareholder representation on the Lagardère board. Likewise, at German blood testing group Biotest, shareholder Polygon Global Partners called for a special audit to examine its concerns over a potential conflict of interest. Biotest had announced that it intended to appoint the CEO of Bio Products Laboratory (BPL) to its supervisory board. Polygon argued that BPL was a direct competitor to Biotest, and the appointment therefore created a conflict.

ESG concerns also surfaced prominently at Volkswagen, where investors at the automaker's AGM in September again raised concerns over the "diesel gate" emissions cheating scandal and heavily criticised the group's governance, notably the absence of independent directors on VW's supervisory board.

The Red and Amber Alert lists: who are the activists' next targets?

The refreshed AAA model has identified 161 corporates considered to be at significant risk of public shareholder activism. This is up from 158 in December 2019.

Of the 158 companies we identified in our December 2019 report as being at risk over the next 18 months, 44 have already been publicly targeted by activist investors.

Note: 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. We are happy to disclose the rating for individual companies if they contact us.

The full methodology can be found on page 15.

What do red and amber warnings mean?

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

A **red** alert indicates that a company is likely to become a target within the next 6-12 months.

An **amber** alert signals a medium-term risk of becoming a target within 12-18 months.

You can view all previous reports here

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

Countries (as at 30 September 2020):

23 ▼	**U.K.** Total: **60** ▲	37 ▲
9 ▼	**France** Total: **25** ▲	16 ▲
10 ▼	**Germany** Total: **25** –	15 ▲
5 ▼	**Scandinavia** Total: **15** –	10 ▲
4 ▼	**Switzerland** Total: **11** –	7 ▲
5 –	**Italy** Total: **11** –	6 –
4 –	**Benelux** Total: **10** –	6 –
2 ▼	**Spain** Total: **4** ▼	2 ▼
Total: 62	**Total: 161**	**Total: 99**

Sectors (as at 30 September 2020):

24 ▲	**Industrial** Total: **61** ▲	37 ▲
10 ▼	**Technology** Total: **29** ▲	19 ▲
9 ▼	**Consumer** Total: **25** ▼	16 ▼
8 ▲	**Healthcare** Total: **17** ▲	9 ▲
3 ▼	**Materials** Total: **8** ▼	5 ▼
3 –	**Communications** Total: **6** ▼	3 ▼
2 ▼	**Energy** Total: **5** ▼	3 ▼
3 ▼	**Other** Total: **10** ▼	7 ▲
Total: 62	**Total: 161**	**Total: 99**

Indicators showing change compared to our December 2019 report ▲ ▼ –

Forecast and outlook for 2021

The AAA model analyses the changes over time in 44 variables that can be broadly grouped under the following headings:

- Country
- Sectoral
- Environment, Social and Governance
- Profitability
- Assets and liabilities
- Equity value and structure

In this report we again focus on the Country, Sectoral and Environmental, Social and Governance groupings, including data on boardroom diversity. We have previously demonstrated that ESG ratings are a significant predictor of potential activism and this effect is apparent once again.

Our refreshed analysis shows that once companies start to underperform, on average they have 2.1 years before activists intervene. In our December 2019 report, this time lag was shorter at just 1.9 years.

We believe this increase has been caused by the relative pause in public activism since February this year due to COVID-19.

We expect this to reverse in the coming months as the upheaval caused by the pandemic produces more opportunities for activists waiting to deploy capital against underperforming companies.

Country trends

Although the U.K. remains the country most targeted by activist funds, during 2019 they were increasingly looking to Continental Europe. However, we expect the fundamental reset caused by COVID-19 to refocus activist attention towards U.K. targets.

This is partly because of the U.K.'s relatively shareholder-friendly governance and regulatory environment, and because U.K. companies have been particularly disrupted by the pandemic's effects.

This disruption is evidenced by the return on capital employed dropping 0.8 percentage points for the average U.K. company over the six months to the end of September 2020, compared with a 0.4 percentage point decline across Continental Europe.

However, we should also highlight that the U.K. is relatively overweight in the consumer sector and we predict that the continuing decline in activist interest in this sector will partly offset the overall increase in U.K.-focused activism.

The net result is that the U.K. is predicted to see the biggest increase in public activist campaigns, with 60 companies now at risk compared with 54 in December 2019. As a result, the U.K. accounts for 37% of all at-risk companies, up from 34% a year ago.

The picture in **France** is broadly stable compared with last year, with 25 predicted targets, up one from December 2019.

However, France is home to a relatively high proportion of technology companies, a sector that we predict will attract increasing attention from activists.

For **Germany**, the number of targets is stable, although it is striking that the share prices of German companies targeted by activists have underperformed the broader market by 3.9% over the past two years, illustrating the challenges for activists in mounting successful campaigns in that market.

Switzerland is steady on 11 targets, although this obscures some notable trends in sectors where the country is relatively overweight.

Interest in the materials sector is predicted to decline while healthcare companies are forecast to come more strongly into activists' focus. The two opposing trends cancel each other out, leaving the headline figure unchanged.

The level of activism in **Spain** is predicted to decline thanks to Spanish companies' outperformance during 2020 in terms of gross margin, EBITDA, return on capital employed and cash generation.

The net result is that the U.K. is predicted to see the biggest increase in public activist campaigns

Sectoral trends

At a sector level, the pandemic has added momentum to existing trends within the industrial, consumer, technology and healthcare spaces:

Industrial companies continue to form the largest group of predicted targets, accounting for 38% of the total, up from 33% in December 2019. This is not surprising, given the serious impact of COVID-19 restrictions right across the sector.

The **consumer** sector continues to move in the opposite direction with 25 predicted targets, down from 32 in December 2019 and 43 in December 2018.

Consumer-facing companies are among the worst-affected by the pandemic, with 30% more share price volatility than the overall market average. The steady decline in likely targets illustrates the extent to which deep disruption – predating COVID-19 but intensified by it – has left many of these companies too damaged for activists to regard them as viable candidates for value creation.

We believe, however, that multinational consumer goods conglomerates still offer the potential for activists and expect attention to focus here over the coming year.

Technology companies continue to grow in importance for activists, with 29 companies now predicted to be at risk, up from 24 a year ago. This sector has generally weathered the COVID-19 storm well, with only minimal revenue losses. However, profitability has been much more mixed.

The potential for tech companies to produce high returns on capital will naturally draw attention to the laggards, while we anticipate that 'Big Tech' including Alphabet, Facebook and Twitter will remain favourite targets for ESG activism.

The final notable sector in our analysis is **healthcare**, which has 17 predicted targets against the 14 identified 12 months ago.

With healthcare companies playing an integral role in the response to COVID-19, it may seem surprising to see a growing number "at-risk". Indeed, the sector has outperformed the market in terms of revenue growth and gross margin.

However, this has not carried through into stronger earnings, with the sector marginally underperforming the market on average. Healthcare companies benefit from positive public and market sentiment, which is likely to make them challenging targets for activist investors.

Despite this, boards and management teams in underperforming healthcare companies should not expect to escape scrutiny.

Across all the sectors, the pandemic has exposed the need for many companies to reassess and restructure their corporate operating models. As a result, we expect a greater demand from activists for operational transformation to deliver much needed additional value.

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Environmental, Social and Governance

The December 2019 report demonstrated the link between European companies' ESG ratings and their likelihood of becoming a target for activists, with powerful evidence that targeted companies were more likely to fall into the bottom two ESG rating quartiles.

Our latest research confirms this finding (see chart on following page). Given the well-documented correlation between higher ESG ratings and strong financial performance, we predict that companies with relatively low ESG scores will figure prominently among those targeted by activist investors during 2021.

It is also clear that investor interest in ESG, and particularly its environmental and social dimensions, has intensified since the COVID-19 pandemic began. The Black Lives Matter protests have led to a big increase in calls for companies to disclose and accept accountability for the racial mix of their workforce and leadership.

Diversity is quickly becoming a key area of concern for ESG-focused investors. Our analysis over recent years also shows the importance of diversity on company boards: companies with a more even gender balance are at lower risk of being targeted.

Environmental concerns, meanwhile, led to a major shareholder revolt at Procter & Gamble's annual meeting in October. Some 67% of the consumer goods conglomerate's shares were voted in support of a motion criticising its use of materials such as wood pulp and palm oil.

Also, in October, Legal & General Investment Management warned 500 companies to do more to address climate change or face being named publicly by the U.K.'s largest asset manager.

Developments such as these illustrate the growing willingness of mainstream institutions to countenance public ESG activism – in line with growing public concern. They also open an important new front for traditional activist investors.

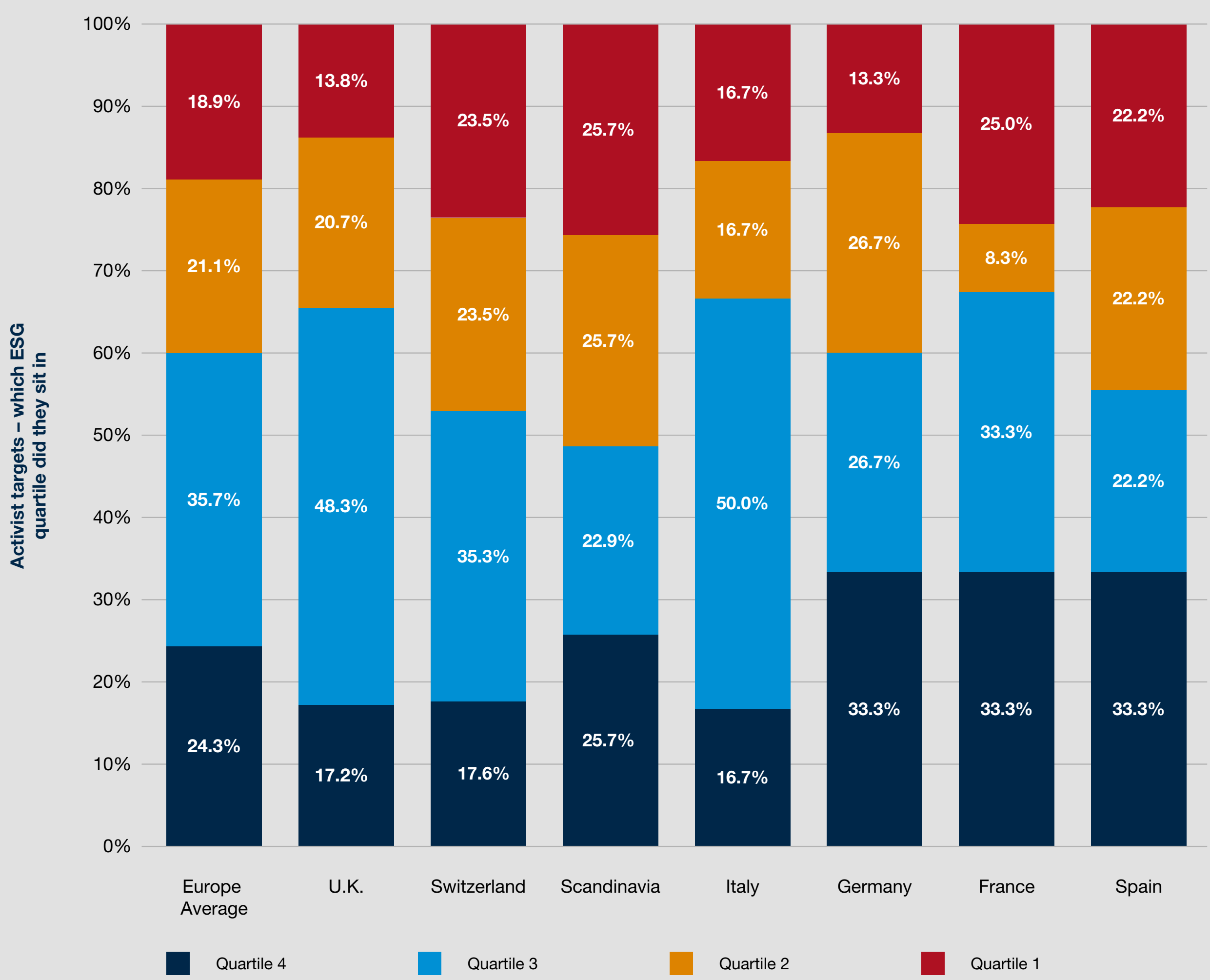
We expect to see activists continuing to follow this market trend and take advantage of ESG-related opportunities to help build wider coalitions with mainstream institutional investors.

In the current climate, attacking companies on ESG grounds – rather than purely on financial performance – could help activists avoid appearing insensitive to the crisis facing businesses and society.

The powerful boost that COVID-19 appears to have delivered to ESG concerns highlights another important way in which the landscape for shareholder activism has shifted this year.

Companies with relatively low ESG scores will figure prominently among those targeted by activist investors during 2021.

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



Activist targeting by ESG quartile

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 2020.

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.

The total number of companies analysed for this report was 1,601, compared with 1,597 in the December 2019 report.

Our research team analysed 207 situations in which activist investors had made public requests to company boards, an increase from 204 in the December 2019 report. We then compared those 207 publicly targeted companies with 1,394 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 robustly and consistently. In addition, private campaigns do not bring a high level of financial and reputational risk to the target company that comes with public campaigns.

Our ESG analysis used ESG ratings obtained from Bloomberg and Refinitiv for our universe of 1,601 European corporates. These ratings were split into four quartiles for the entire sample, and each of the countries/regions. We then identified those companies in each quartile that had been targeted by activists since 2017. This enabled us to identify which quartiles contained the largest numbers of targeted companies.

What we measure

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 44 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?

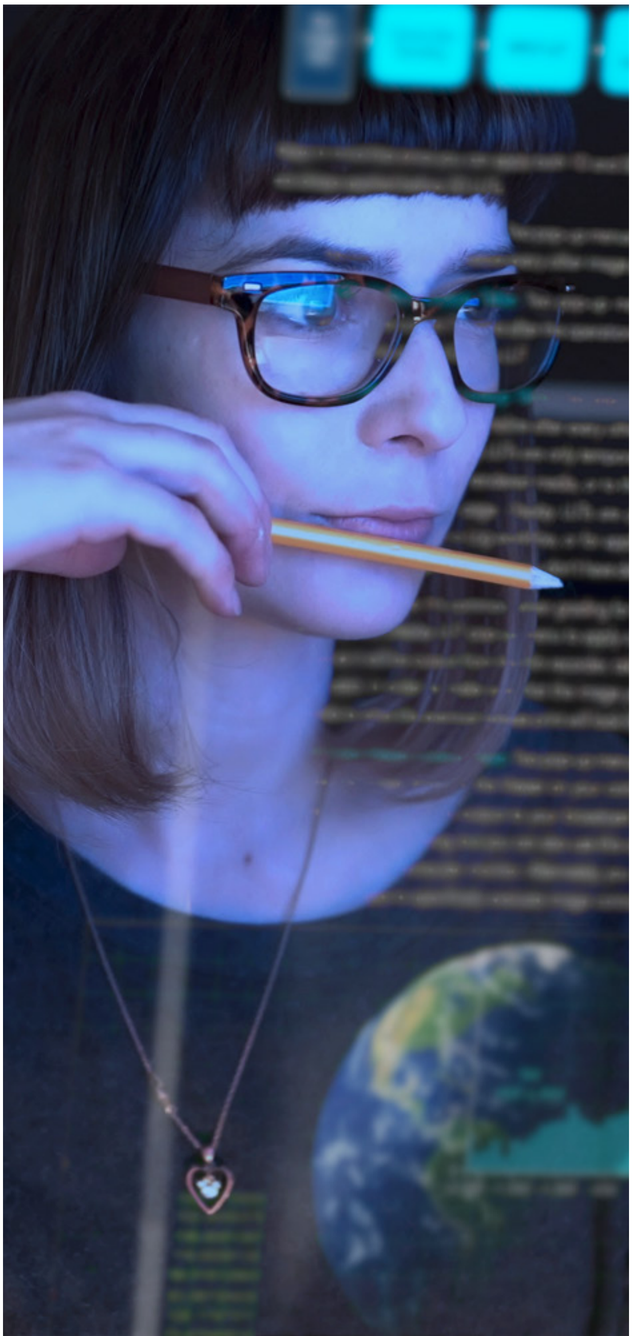
Evolution – how is the importance of each of these factors changing over time?

Our predictive model calculates a 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.

The need to fundamentally reassess and restructure corporate operating models will lead to a greater demand from activists for operational transformation.

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. 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: Leadership. Action. Results SM

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

Stage 1: How would an activist attack your company?

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: How can your company get on the front foot to avoid the attack?

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

Stage 3: How can your company sustainably keep ahead of activists?

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

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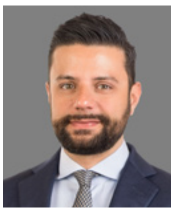

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ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and 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. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 5,000 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, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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