2022 shareholder activism proxy season review

Building a better working world

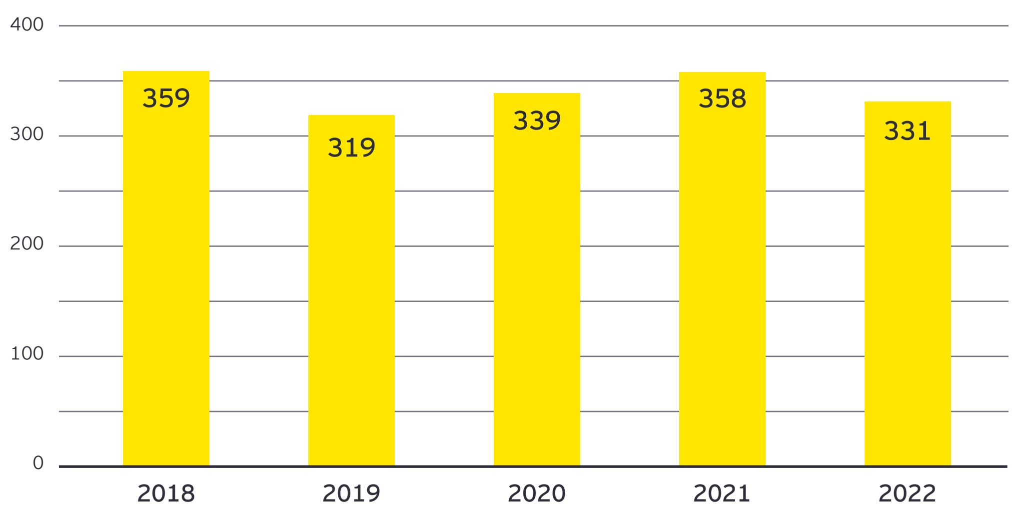
Contents

Shareholder activism campaigns decline in 2022; ESG moves to the forefront

Tempered by geopolitical tensions and regulatory changes, shareholder activism in 2022 pulled back from the post-pandemic rush of activity in 2021. In the 12 months ended June 30, 331 new activism campaigns were initiated globally, a decline of 8% from the prior year. This is the lowest recorded campaign activity since 2017, when there were just 303 campaigns. Regionally, the US continues to lead global activity, but European activity continued to be strong despite concerns surrounding the war in Ukraine. The activism landscape is ever evolving, and 2022 has been no different. The year brought new regulatory changes – and significant potential changes may be on the horizon. Activists are increasingly leveraging environmental, social and governance (ESG) as a focus area of campaigns, beginning to turn their backs to short activism and are finding new partners in private equity.

Shareholder activism campaigns globally [1]

Total campaigns

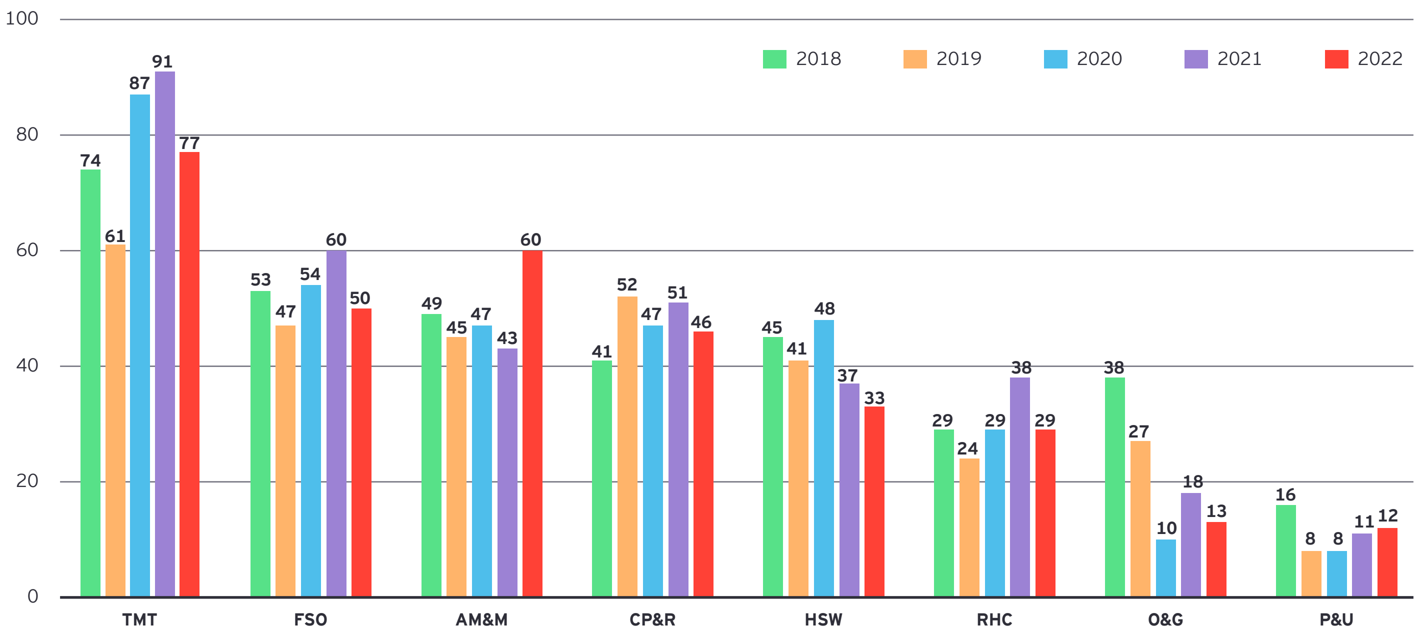


Campaign activity remained strong in the technology, media and telecommunications; financial services; and consumer products and retail sectors. After a few years of sluggish activity, an increased number of Advanced Manufacturing & Mobility companies were targeted in 2022. M&A-related and operational demands were most common in the sector. Notably, Starboard Value targeted Huntsman Corp., criticizing the company's below-average margins and missed revenue growth and EBITDA margin targets. Starboard nominated four directors, and after a contentious proxy fight, none garnered enough support to be elected to Huntsman's board. The campaign marked the first time a company successfully defeated a prominent activist without the support of proxy advisory firm Institutional Shareholder Services (ISS) in seven years.

[1] *Source: EY analysis of FactSet data as of June 30, 2022. Annual data is on proxy season basis (July 1–June 30). All data based on campaigns against companies with market cap >$500m at time of announcement.*

Shareholder activism campaigns by sector [2]

Campaigns by Sector



TMT – Technology, media & telecommunications
FSO – Financial services
AM&M – Advanced manufacturing and mobility
CP&R – Consumer products and retail
HSW – Health sciences and wellness
RHC – Real estate, hospitality and construction
O&G – Oil and gas
P&U – Power and utilities

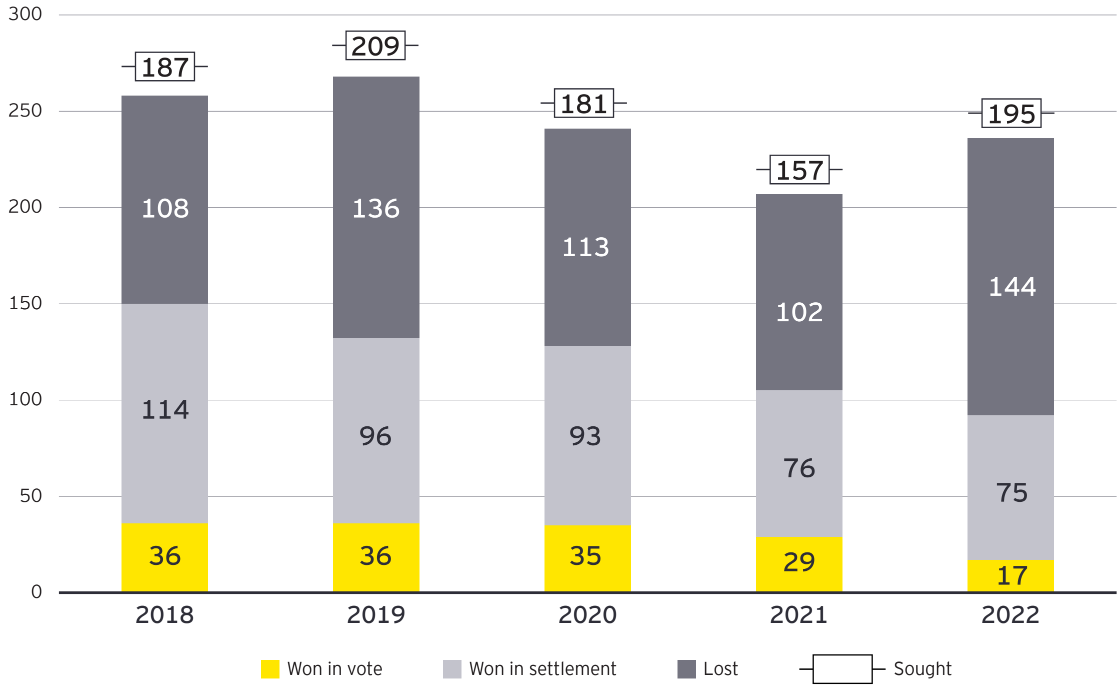
[2] *Source: EY analysis of FactSet data as of June 30, 2022. Annual data is on proxy season basis (July 1–June 30). All data based on campaigns against companies with market cap >$500m at time of announcement.*

While prominent activists Elliott Management, Starboard Value and Carl Icahn still top the leaderboard, new players are making a name for themselves in the space. In 2022, Alta Fox, a small hedge fund run by former Scopia analyst Connor Haley, launched two high profile campaigns. The first a campaign against Hasbro, nominating five directors to the board and calling for a spinoff. While the campaign was ultimately unsuccessful, it lifted Alta Fox's profile significantly. Following its campaign on Hasbro, Alta Fox launched a campaign at de-SPAC transportation company Daseke, calling for the company to take advantage of depressed valuations to launch a share buyback program.

In May 2022, just a few months after Trian reportedly built a stake in Unilever, the company appointed Trian founder Nelson Peltz to the board. Settlements remain the preferred method for gaining board seats. Faced with the potential of a distracting, cost and labor-intensive campaign, many companies choose to settle quickly. New universal proxy requirements put in place for the 2023 proxy season will make it even easier for some activists to get directors added to the board in a proxy fight, as investors now have a full menu of alternatives to choose from on a proxy card, which will likely increase the pressure on boards to settle.

Outcomes of board seats sought by activists [3]

Board seats



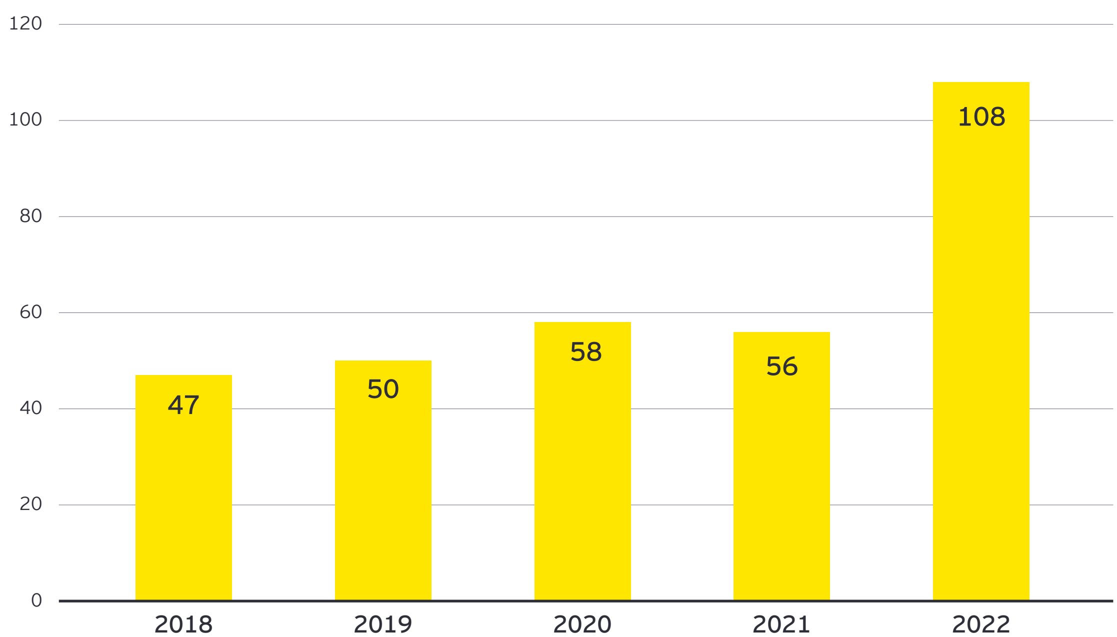
[3] *Source: EY analysis of FactSet data as of June 30, 2022. Annual data is on proxy season basis (July 1-June 30). All data based on campaigns against companies with market cap >$500m at time of announcement.*

Other key themes and takeaways from the year

ESG proposals are on the rise

The continued rise of ESG has shaken up activism, and ESG is increasingly top of mind for activists and shareholders alike. The number of ESG proposals has nearly doubled since last year due to both government regulations and a growing focus on stakeholder capitalism.

ESG-focused activism campaigns [4]



[4] Source: EY analysis of FactSet data as of June 30, 2022. Annual data is on proxy season basis (July 1-June 30). All data based on campaigns against companies with market cap >$500m at time of announcement.

Continued ESG activism in "big oil"

After the surprisingly successful campaign against ExxonMobil last year, other activists are now taking advantage of the global energy transition to pressure major oil companies to accelerate their progress on initiatives and in some cases explore radical changes to their operating model.

Many prior ESG campaigns argued for lofty, aspirational goals but lacked a compelling case for why those goals would create shareholder value. These new campaigns make a clear connection between the ESG goals and shareholder value creation. These arguments are key to creating a sympathetic audience among major institutional investors whose voting behavior is increasingly being guided by ESG principles. However, major activists leading with ESG claims almost always have additional, underlying demands from the traditional activism playbook, such as divestitures, acquisitions, and management changes.

An example of a recent campaign is Third Point's investment in Shell. In Third Point's 2021 Q3 investor letter, which announced its campaign, it linked shareholder value to how they believed Shell was managing the energy transition and the competing business and environmental demands from its disparate stakeholders. However, the changes Third Point called for are very traditional. Third Point is urging Shell to realize more value for shareholders by splitting into two entities, separating its legacy fossil-fuel business from its liquified natural gas, renewables, and marketing business. The activist argues that the separation will optimize shareholder interest, as ESG-focused investors want to support Shell's renewables efforts, while others seek the return of capital from Shell's legacy business as it slows new capex and sells assets. As a result of this split, Third Point believes that the businesses will be free to pursue different strategies which would increase shareholder returns and accelerate the decarbonization of Shell overall.

This campaign sits at an interesting intersection of activism and institutional investing, where activists are explicitly (rather than implicitly, as many prior activism campaigns have relied on) leveraging ESG investors power. Third Point's primary cause for splitting the business is to optimize shareholder interest for renewables, as many ESG funds will not invest in Shell given its legacy oil and gas businesses. This certainly is not the first time an activist has called for a company breakup, as nearly 53% of activism campaigns in 2022 included an M&A related demand, but it is the first time the impetus for the separation is to attract ESG investors. As the energy transition continues, we expect to see this argument gain more traction with shareholders.

Pressure for uniform ESG reporting grows

With more attention and investments going to ESG investing, pressure is mounting on the credibility and measurement of ESG reporting. In March, the SEC announced its proposed climate disclosure rules that would create standardized climate disclosures for companies, helping investors make informed decisions about the impact of climate risks on their investments.

The proposed rules were met with mixed sentiment—while they mean strict, prescriptive standards and high compliance costs for companies, many investors were encouraged by the prospect of legitimizing ESG claims and having a consistent standard by which to compare companies. Activists taking an ESG angle will often exploit inconsistent or inaccurate ESG reporting. While this set of proposed rules will put all companies on an even playing field, it will also help activists identify ESG laggards more quickly and give them a consistent standard by which to benchmark them. Given the magnitude of pushback from critics, and as this is one of the most comprehensive proposed regulatory updates in years, it is likely that the final rules will differ significantly than those proposed. The SEC extended its comment period until mid-June 2022, and further updates from the commission are expected in the coming months.

New shareholder proposals met with pushback from institutional investors

The SEC's recent rule change that widened the scope of allowable topics for shareholder proposals has led to more proposals related to ESG issues, but so far, the investor support has been limited.

One of the primary goals of the new guidelines is to encourage shareholder's input on environmental and social issues. In 2022, 924 environmental and social shareholder proposals had been filed as of mid-June, up 10% from the same time in 2021.[5] As the proxy season progresses, we expect to see a record number of shareholder proposals. The rule change has also made it more difficult for companies to block the proposals from proxy ballots. Before the change, if the shareholder proposal was too specific, too vague or not considered to directly impact the issuer's business, it could be thrown out. So far this year, 55% of no-action requests from companies on ESG shareholder proposals have been rejected by the SEC, which means the topic must be put forth to a vote. This rejection rate from the SEC is significantly higher than in prior years, in 2021 the rate was 39%.[6]

In a recent publication, BlackRock announced it believes the SEC's recent rule change that broadens the scope of permissible shareholder proposals has led shareholders to put forth proposals that are more prescriptive and constraining on management. BlackRock also believes the unique and medium-term challenges to the energy industry following the war in Ukraine mean companies will need to invest in both traditional and renewable energy sources to produce attractive returns for shareholders. As a result of these two beliefs, BlackRock said the firm was "likely to support proportionately fewer [shareholder proposals] this proxy season than in 2021"[7] as restrictive 2022 proposals are not considered to be consistent with the company's long-term financial interest. As a result, ESG-focused activists are not likely to find institutional investor support for their more extreme ideas or those less clearly connected to shareholder value. However, pension funds have been somewhat more receptive to more restrictive proposals advanced recently, with the New York State Pension Fund and CalPERS lending support to such proposals made by shareholders at several large companies this year, including Berkshire Hathaway, Bank of America, Goldman Sachs and JPMorgan.

Activists and private equity are teaming up

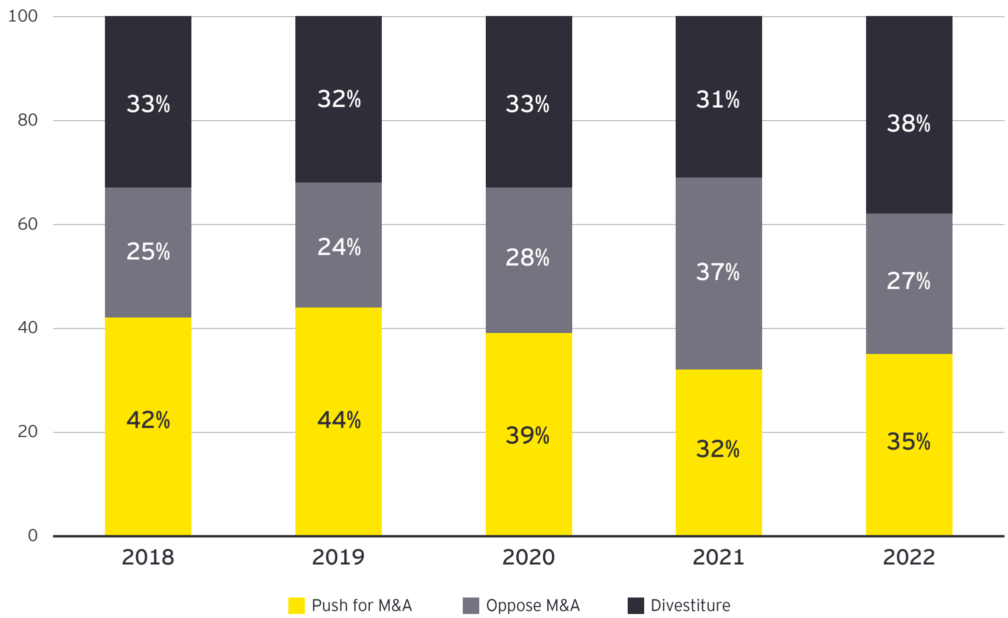
Private equity funds and activists are increasingly partnering together and borrowing strategies from each other's playbooks. While private equity firms and activists have always shared similar interest in underperforming companies, the recent rise in capital available to both has led some to find targets where incentives are aligned and partnering can increase returns for both parties. Two of the largest private equity deals of the year, Citrix and Nielsen, came after activist campaigns and featured an activist teaming with a traditional private equity firm (Vista Equity Partners and Brookfield respectively) to pursue a take-private transaction. In addition to their capital, activists tend to seek out private equity firms that have strong industry expertise that they can bring to the table. This bolsters their credibility and helps secure a deal.

At the same time, some traditional activists are beginning to act like private equity players. This year, prominent activist Trian announced it intends to explore the possibility of taking Wendy's private, after actively engaging with the company for years. Formerly a "last resort" strategy for an activist, it is possible that larger activism funds will increasingly consider a buyout as an attractive option.

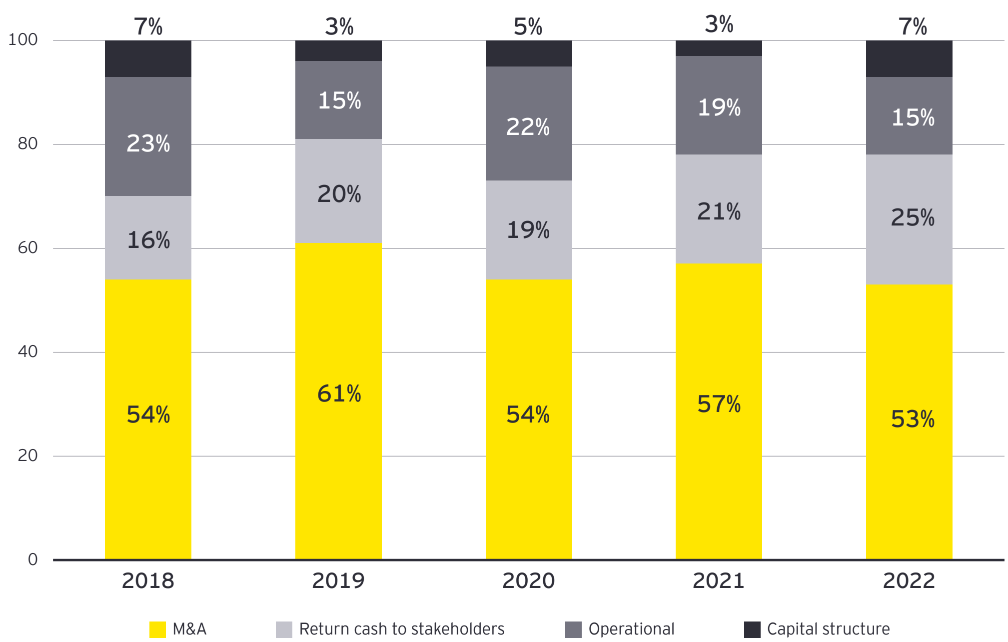
[5] *Harvard law school forum on corporate governance: an early look at the 2022 proxy season.*
[6] *Insightia activism newsletter, 24 May 2022.*
[7] *BlackRock Investment Stewardship Commentary, May 2022*

Activists pushing for more divestitures

Changing M&A demands [8]



Value-creation demands [9]



[8] *Source: Activist Insight as of June 30,2022. All data based on hedge fund campaigns against companies with market cap >$500m at time of announcement.*

[9] *Source: ActivistInsight as of June 30,2022. All data based on hedge fund campaigns against companies with market cap >$500m at time of announcement.*

As broader M&A activity is slowing down, M&A-related activism campaigns have slowed as well. In last year's dealmaking frenzy, more activists were opposed to deals, pushing for better offer prices. Now in 2022, the split is roughly equal between activists pushing for M&A and those opposing it. More activists now than ever are pushing for divestitures, urging companies to unlock value by streamlining businesses and optimizing corporate structures. In May, Western Digital came under activist pressure to conduct a review of the value of separating its hard disk drives and flash memory businesses. A month later, the company reached a standstill agreement while it conducted its strategic review.

M&A activity is expected to slow in 2022 as a result of geopolitical tensions, increased regulatory scrutiny and concerns around an economic downturn. M&A transactions in the first quarter were the lowest recorded since the start of the COVID-19 pandemic, a trend experienced globally. While down compared to prior years, M&A is still a major driver in activism and will continue to be a preferred tool for activists to realize shareholder value in the future.

In the latest campaign against Kohl's, which has been beleaguered by numerous activist demands since early 2021, Macellum Advisors called for the company to sell itself. The call came after Kohl's defeated Macellum in a proxy fight, where the activist nominated a slate of 10 directors and urged Kohl's to decrease costs, evaluate a sale leaseback and initiate a strategic review. Macellum was also part of an activist consortium that targeted the company in March of 2021, calling for board change.

Governance continues to be a core concern

Governance remains a key item of focus for proxy advisors. ISS and Glass Lewis continue to pursue stringent governance standards and are punishing companies that are not in compliance. In instances of a dual-class share system, Glass Lewis has recommended withholding votes from directors, and while ISS recommended supporting the directors, it said the firm will change its policy next year to generally vote against directors or boards if they continue to employ a multi-class structure with unequal voting rights.

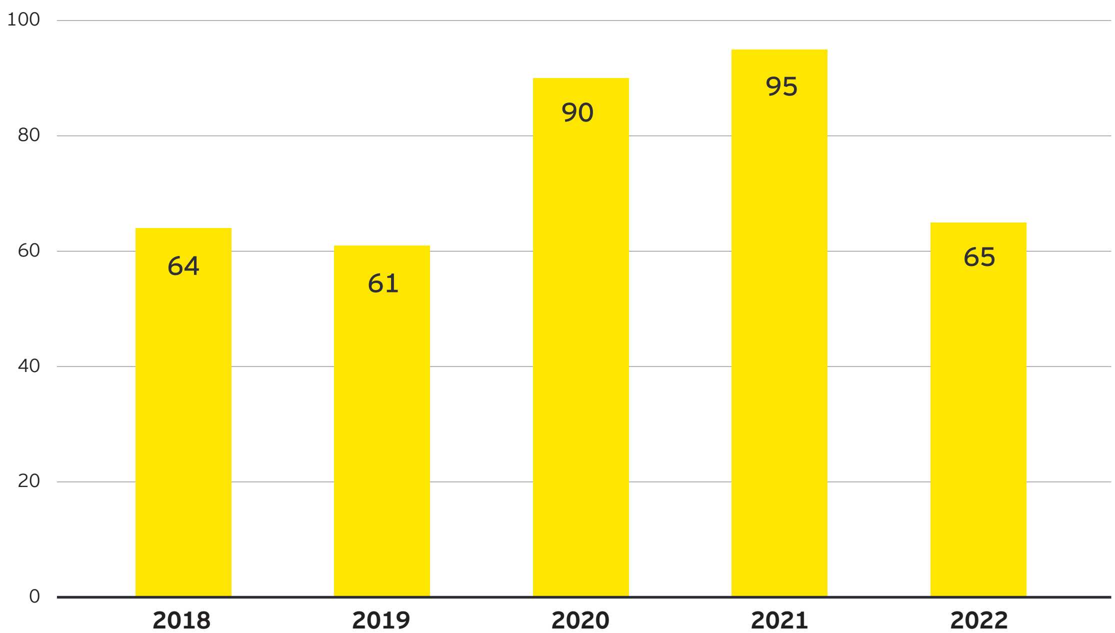
ISS and Glass Lewis continue to have significant clout on issues of corporate governance, but in response to concerns that they wielded too much influence, major institutional investors have sought to highlight their independence on proxy voting issues. Both BlackRock and Vanguard addressed ISS and Glass Lewis directly with statements that their research was valued but just one of many inputs to their stewardship teams' decisions. Many asset managers still vote in lockstep with their proxy advisor of choice, but they could increasingly be swayed by BlackRock and Vanguard in situations where they break from the proxy advisor's recommendations.

Companies have increasingly called for more transparency from proxy advisors, and now more companies are publicly pushing back against their recommendations. This year, ISS recommended voting against Twitter director Egon Durban, saying he sits on too many other public company boards. Nearly 57% of shareholder votes were against Durban at their annual meeting in May, and Durban tendered his resignation. Twitter refused to accept his resignation, saying that Durban has "unparalleled operational knowledge … and an invaluable skill set and experience with mergers and acquisitions" and that his resignation was "at this time is not in the best interests of the Company." Instead, Twitter promised shareholders that Durban will decrease the number of his outside boards from six to five over the next year.

Short activism begins its decline

Short activism campaigns by year [10]

Short campaigns



[10] *Source: EY analysis of FactSet data as of June 30, 2022. Annual data is on proxy season basis (July 1-June 30). All data based on campaigns against companies with market cap >$500m at time of announcement.*

This year federal prosecutors began investigating short sellers, seeking to uncover if firms engaged in illegal trading activity by releasing negative research reports to drive down share prices. Muddy Waters' founder, Carson Block, was served a search warrant by the FBI as a result of the investigation. Federal agents are also investigating Citron Research's Andrew Left and seized his computers and issued subpoenas to more than a dozen other market participants.

Legendary activist Bill Ackman of Pershing Square this year told investors that he will no longer engage in short selling activism campaigns and will instead focus on being a "supportive constructive owner." Ackman isn't the only one steering away from short campaigns – activists are broadly moving away from them. There were just 65 short campaigns in the 2022 proxy season, 32% fewer than in 2021.

As activists continue to refine their images from that of the corporate raiders of the 90s to change-making partners (and increasingly, purported champions of ESG), we expect that short activism will likely continue to decline.

Emerging trends

Activism in a bear market

Sparked by the war in Ukraine and further exacerbated by the investors' doubts about the Federal Reserve's plan to fight inflation, markets have been volatile in recent months. Speculative investments, which have enjoyed a spectacular run over the last year are facing the most pressure, though few stocks have been spared.

One potential side effect of the recent volatility could be additional activism activity. The volatile market exposes vulnerable companies with high betas, as these companies will experience more price volatility than the rest of the market. This provides an attractive entry point for activists, and the decline in returns bolsters their argument for change.

As bear market fears grow and market volatility increases, activists are likely starting to circle around those most vulnerable. Pre-revenue and pre-profitable companies are likely to be more vulnerable as investors begin to question intrinsic values. However, traditional activists may find it hard to make a case for activism at these companies that will generate a return for their fund. Instead, they are more likely to target established companies in attractive industries that are subject to increased volatility.

In a bear market, catalysts for upsides will be somewhat limited, which means investors might be more receptive to activist's push for change. If investors have already lost a significant portion of their investment, they have less to lose supporting an activist that promises to bring change and improve shareholder value. The ease of voting for some of a dissident's nominees or proposals on the new universal proxy will further encourage investor support of activist's proposals.

"Spac-tivism" falls short

In 2021, more than 423 companies completed de-SPAC transactions.[11] Of those de-SPAC companies, approximately 58% were trading below the SPAC IPO price of $10 at the end of 2021.[12] This trend is likely further exacerbated by the current volatile market environment. Beyond trading performance, many de-SPACs are faltering. At least 25 companies that completed de-SPAC transactions between 2020 and 2021 have issued going concern warnings recently.[13] The outlook is equally grim for SPACs that have yet to merge – last quarter, investor's withdrawal rate rose to 60%,[14] a sign that investor enthusiasm for SPAC deals is waning.

While a number of SPACs have created a compelling short thesis this year, fewer activists have targeted them. As previously mentioned, short campaigns in the US are on the decline, after peaking in 2021. The lack of activist attention given to SPACs is somewhat surprising, however, it is likely attributed to the overall decline in short selling and general lack of upside for activists. Given the recent crackdowns on short sellers, activists may pursue SPACs with more traditional activism tactics, such as calling for the company to engage financial and legal advisers to commence a review of strategic alternatives focusing on the sale of the company.

[11] *Market Realist: forget 10x ideas, SPACs are struggling to even trade above $10, 7 September 2021.*

[12] *"The SPAC boom is over with the majority of deals now trading under key $10 level," CNBC, 6 September 2021*

[13] *Wall Street Journal: SPACs are warning they may go bust, 27 May 2022.*

[14] *Wall Street Journal: the SPAC ship is sinking, investors want their money back, 21 January 2022.*

"Heart" activism from surprising dissidents

> "I want to shine a light on what may be the biggest hypocrisy of our time: a large number of Wall Street firms and their bankers and lawyers appear to be capitalizing on ESG to drive profits without doing nearly enough to support tangible societal progress ... clearly, the ESG status quo on Wall Street needs to change. [16]
>
> – Carl Icahn

Partly spurred on by the influx of ESG investing, "Heart" activism grabbed news headlines in 2022. Ernst & Young LLP defines "Heart" activism as activism that is not financially motivated, but is driven purely by a personal, social or environmental agenda. Legendary activist Carl Icahn unsuccessfully targeted McDonald's and Kroger this year, attempting to wage a proxy fight to add two director nominees to each board over animal welfare concerns. More specifically, Icahn is opposed to gestation crates used by pork suppliers of both companies. "I really do feel emotional about these animals and the unnecessary suffering you put them through," said Icahn in an interview with Bloomberg.[15]

While Icahn's namesake fund boasts billions in assets under management, Icahn only owns 200 McDonald's shares, a fraction of a typical activist stake. The activist lost his proxy fight against McDonald's, only receiving about 1% of the votes after proxy advisors ISS and Glass Lewis both backed McDonald's. ISS said Icahn had not "presented a definitive argument that MCD's gestation crate progress is cause for immediate board change."

Following the defeat at McDonald's, Icahn withdrew his nominees at Kroger, ending his proxy fight at the grocery chain. In a letter to Kroger and McDonald's shareholders, Icahn said that the lack of support for his proposals was likely due to the fact both companies were performing well. He reiterated that he would continue to hold management teams and boards accountable for the ethical treatment of animals and welfare of their employees.

In Europe, Bluebell Capital Partners launched a solely ESG-focused campaign against a large chemical company in late 2020. Bluebell demanded the company review its ESG practices and stop the practice of dumping chemical and metal waste from its Tuscany factory into the Mediterranean. The dumping continued, and in September 2021 Bluebell called for the company's CEO to be replaced for failing to address the issue. At the company's 2022 annual meeting in May, shareholders ultimately supported the company despite strong criticism from several large pension funds and Glass Lewis. The Solvay campaign is part of Bluebell's nonprofit initiative, "One Share ESG Campaign," where the activist holds only one share of the target company so as not to have any material financial interest. Instead, it leverages its expertise as a financial activist investor to "address on a pro bono basis, significant environmental or social issues, as part of our broader ESG commitment."[17]

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[15] *"Interview with Carl Icahn," Bloomberg TV, 16 February 2022.*

[16] *Letter to Shareholders of McDonald's Corporation by Carl Icahn, 21 April 2 2022.*

[17] *Response to Solvay Board Open Letter Regarding Soda Ash Operations in Rosignano by Bluebell Capital Partners, 17 February 2022.*

Investors opposing say-on-pay proposals

The median CEO pay package for America's largest companies reached $14.7m in 2021, the sixth year of setting a new annual record.[18] Shareholders are growing weary of these pay increases and have started withholding their support for major companies' say-on-pay proposals. While nonbinding, these proposals typically garner 90%+ support from shareholders, and are an important bellwether in shareholder's management sentiment. As of late May, 23 companies in the S&P 500 have reported less than 70% support for their executive-compensation programs.[19] One-time awards and how closely executive compensation is linked to performance are common shareholder concerns. In the case of JPMorgan, just 31% of shareholders voted in favor of the bank's compensation plans with specific objections to Jamie Dimon's $50m retention bonus.[20] As ESG becomes a larger part of investment voting decisions, executive compensation practices may face further investor scrutiny.

Universal proxy changes proxy voting landscape

Beginning in September 2022, new rules will allow shareholders voting by proxy to elect directors from a full list of candidates nominated by both the company and a dissident in contested board elections. Universal proxies will give investors more effective means to influence the makeup of the board, will provide a more even playing field for those voting by proxy, and give investors more options to express their view on who should be on the board. The new rules may lead to a higher volume of proxy contests and could mean that more individual directors become targets.

[18] *Pay Packages for CEOs Rise to Record Level, Wall Street Journal, May 15, 2022*

[19] *Say on Pay: Approval Slides as CEO Pay Rises, Equilar, June 15, 2022*

[20] *Form 8-K, JPMorgan Chase, May 17, 2022*

Implications for companies

What does this mean for management?

- It appears as if the record-setting bull market days are behind us for now, and management may need to have a clear strategy to navigate a potential downturn.
- Management may need to continue to be good stewards of investors' capital and prioritize shareholder value by thinking outside of the box and being unafraid to incorporate new ways of thinking about shareholder value and environmental risks.
- Whether codified by the SEC or de facto enforced by institutional may need to investors and proxy advisors, change is coming to ESG disclosures. Management may need to be ready to be held to new, higher reporting standards. Shareholders will reward companies that are seen as leaders in the space, and laggards will take on added risk of an activist attack.

Implications for boards

- Boards, as always can be one step ahead of the curve. ESG remains top of mind, for the company and the directors themselves. Board members must not be afraid to speak out on these critical matters, and steer the company to making the appropriate environmental, social and governance decisions.
- Activism preparedness may need to be a priority for boards. It is not a one-time task but an ongoing process that requires input from boards, management and advisors. Proactive preparedness can help a company lower its activism risk and be prepared in the event of an activist attack.

How can companies best prepare?

To be prepared, companies may need to have clear action plan to address shareholder activism risk. Key components of a good action plan are:

Identify and address potential vulnerabilities

- Evaluate potential vulnerabilities to activism, both in the current environment as well as expectations on future market conditions.
- Analyze capital structure and capital return policies, including benchmarking against peers.
- Identify leading practices to proactively patch or eliminate areas of weakness.
- Educate management on leading practices of high-impact, low-effort tactical/operational improvements to enhance shareholder value/sentiment.

Develop an activism response plan

- Prepare an internal "fire drill" manual outlining key actions to be taken when an activist shows up.
- Educate management on leading communications practices, including responses to potential angles of attack to enable a swift, compelling and unified front against activist claims.
- Review the company's current shareholder base, analyze trends over time and create a watch list of potential activist investors from public filings.

Simulate a mock activist attack

- Perform an "activist simulation" exercise to better familiarize management and the board with the typical speed and escalation of a live activist attack.
- Educate all parties regarding the rules-of-the-road in the event an activist approaches.

Shape shareholder engagement strategy

- Continue to engage with top shareholders, especially ones that have voted dissident slates in the past.
- Virtual engagement is currently a widely acceptable method of engagement, but shareholders continue to expect involvement of senior management and select directors.

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