

## Activist Investors Set For Busy 2017

By Chelsea Naso

*Law360, New York (January 2, 2017, 1:03 PM EST)* -- Shareholder activism is geared up for a unique year stocked with opportunities and challenges, as a shifting perception of short-term players, an anticipated lightening of the regulatory environment, and the potential for a cash repatriation tax holiday promise to keep hedge funds on their toes while hunting for new targets, experts say.

Here, Law360 looks at trends that will shape shareholder activism in 2017.

### Activists' Focus Returns to Smaller Cos.

Much like 2016, the vast majority of shareholder activism campaigns are expected to target small- to mid-market companies, in a return to the way activism had traditionally been carried out before a handful of campaigns cropped up at some of the largest public companies.

Several factors are likely playing into that trend. Fewer proxy fights are hitting larger companies because the activists launching campaigns are generally more experienced and boards of directors are more willing to host an open dialogue.

"We are seeing fewer campaigns go to a proxy fight at large-market-cap companies, but I still think we're seeing, and you will continue to see, an increasing number of activist investors taking investments and engaging with management of large public companies," said Andrew Freedman, co-head of Olshan Frome Wolosky LLP's activist and equity investment group. "It's just that those tend to be the top-tier activist investors — like the Starboard's, Elliott's and Third Point's of the world — whom companies tend to prefer to work constructively with than to see things go to a proxy contest."

At the same time, there's a shifting perception of activism among institutional investors who are less eager for boards to hurry up and settle. That attitude makes it more difficult for an activist campaign to take off at a larger company.

"Some of the skepticism that has risen among the long-term institutional investors, or at least the caution that has developed among them, it's a lot harder to overcome when you can only own one-

quarter of 1 percent versus when the activist can take a meaningful ownership [position]," said Kirkland & Ellis LLP corporate partner Daniel Wolf.

State Street Global Advisors, for example, put out an October notice outlining the asset manager's wariness of activist models that center on short-term profits instead of the long-term returns of a particular company. State Street urged boards to consider allowing more activist challenges go to a proxy fight, giving all sides more time to review their options and giving long-term investors more of an ability to voice their opinion.

"[If] you have an activist campaign that is really financial engineering without a persuasive critique of the company's business plan, I think it is hard for an activist to win," said Leonard Chazen, a Covington & Burling LLP corporate and securities senior counsel.

There's also the practicality of building a stake in a smaller company. Activists are able to take a more significant position for a smaller cost, which gives their voice more weight among other investors. And the most successful campaigns generally call for mergers and acquisitions, which is a strategy that is much more easily employed at smaller companies.

"Over the last year, year and a half, the most successful outcomes in activist campaigns have really been around forcing the sale of the company or another M&A/strategic alternatives type of strategy," Wolf said. "It's a lot easier to force that on a smaller company."

Whether or not M&A is the strategy that is going to be pursued, smaller companies also tend to have fewer resources, meaning they likely aren't able to scrub their operations for weak points in their strategy and governance the way a large-cap business can.

"Traditional activism has always been toward the smaller companies and the mid-sized companies," said Eleazer Klein, co-chair of Schulte Roth & Zabel LLP's shareholder activism group. "Those are the companies that tend to have more operational issues because they don't have the same level of expertise in-house that helps them perform up to snuff."

### **Energy, Retail and Restaurant Cos. Ripe for Campaigns**

While activists are not generally sector-specific, the energy, retail and restaurant industries are expected to draw the most attention in the coming year, although for different reasons.

Energy and oil and gas companies are becoming healthier as commodities prices rise, which will allow well-positioned and well-run companies to begin to regain their footing. This will also make it easier to spot those that are struggling, Klein noted.

"Oil and gas and energy are areas that were under a lot of pressure value-wise, and that tends to expose companies that aren't operationally up to par. Companies that are well-positioned and well-run will perform a certain way and the ones that are not will start to lag," he said.

Deal-making in the sector is also again a viable strategy, and one that activists are likely to pursue, explained Mark Gerstein, chair of Latham & Watkins LLP's global M&A practice.

"There's a good chance we'll see activists move into that sector and try to take advantage of the growing value in the sector and push for combinations that are feasible again," Gerstein said.

The retail space is facing pressure from the online shopping trend, especially brick and mortar stores, Freedman explained.

"Retail is a tough space right now because of the decline in physical shopping in malls and the Amazon effect. And you're seeing that trickle down to various companies' performance," Freedman said. "The ones with real estate assets, those are going to be really attractive to activists."

And the restaurant industry, where many are struggling to draw in cost-conscious diners, is also home to one of the most successful activists stories on the book: Darden Restaurants Inc.

"We'll continue to see activist investors get involved in the restaurant space in 2017 given how many companies there are undervalued right now. The meal-kit trend and declining grocery prices have put a lot of pressure on restaurants and their same store sales. Also, activists are comfortable investing in restaurants because there's a workable road map at most of them for unlocking value," Freedman said.

### **New Administration Promises Regulatory Shifts**

With President-elect Donald Trump taking office in 2017, his opinions and policies concerning corporate America — including a potential tax holiday and a rollback of the regulatory environment — stand to impact the shareholder activism market.

Trump is said to be considering a tax holiday for U.S. companies' offshore cash, potentially opening the door for U.S. companies to repatriate their cash for M&A, capital investments or share buybacks without facing prohibitive tax costs.

"The whole cash repatriation holiday, that could be a huge multiplier for activism depending on what that tax holiday looks like and what the terms and considerations are on how people can use the cash," said Keith Gottfried, a Morgan Lewis & Bockius LLP partner that focuses on activist defense matters.

Trump is also expected to reduce regulatory oversight, which likely means his appointments to the U.S. Securities and Exchange Commission will be of a similar mind. So there's little chance that any formal rule-making concerning universal proxy access will be on the agenda.

"The consensus is that it's going to lose steam as we go into the new administration," Gibson Dunn's Eduardo Gallardo said.

But in terms of other regulatory changes, particularly at the SEC, it is still unknown what other shifts may be on the horizon.

“What kind of bent are they going to have in terms of regulation and in terms of shareholder activism? Are they going to be someone who is going to want to be more facilitative of shareholder activism or someone who is going to want to be more policing of it more restrictive of it,” Gottfried said

There are also potential changes to fiscal policy on tap for the new year. Interest rates saw a hike at the end of 2016, and with more likely to come in 2017, activist hedge funds will have added sources of yield to compete with if they are fundraising.

“If we see interest rates go up more, it could make it more difficult for activist funds to attract capital because they would be competing for yield,” Gottfried said. “There might be other places where people can get yield than activist funds.”

--Editing by Edrienne Su.

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