If you look at your company the way an activist does, what would you change?

Our in-depth research shows where and how you can harness shareholder activists' tactics for competitive advantage.

By Brad Kuntz, Pranab Panda, Tim Michaels

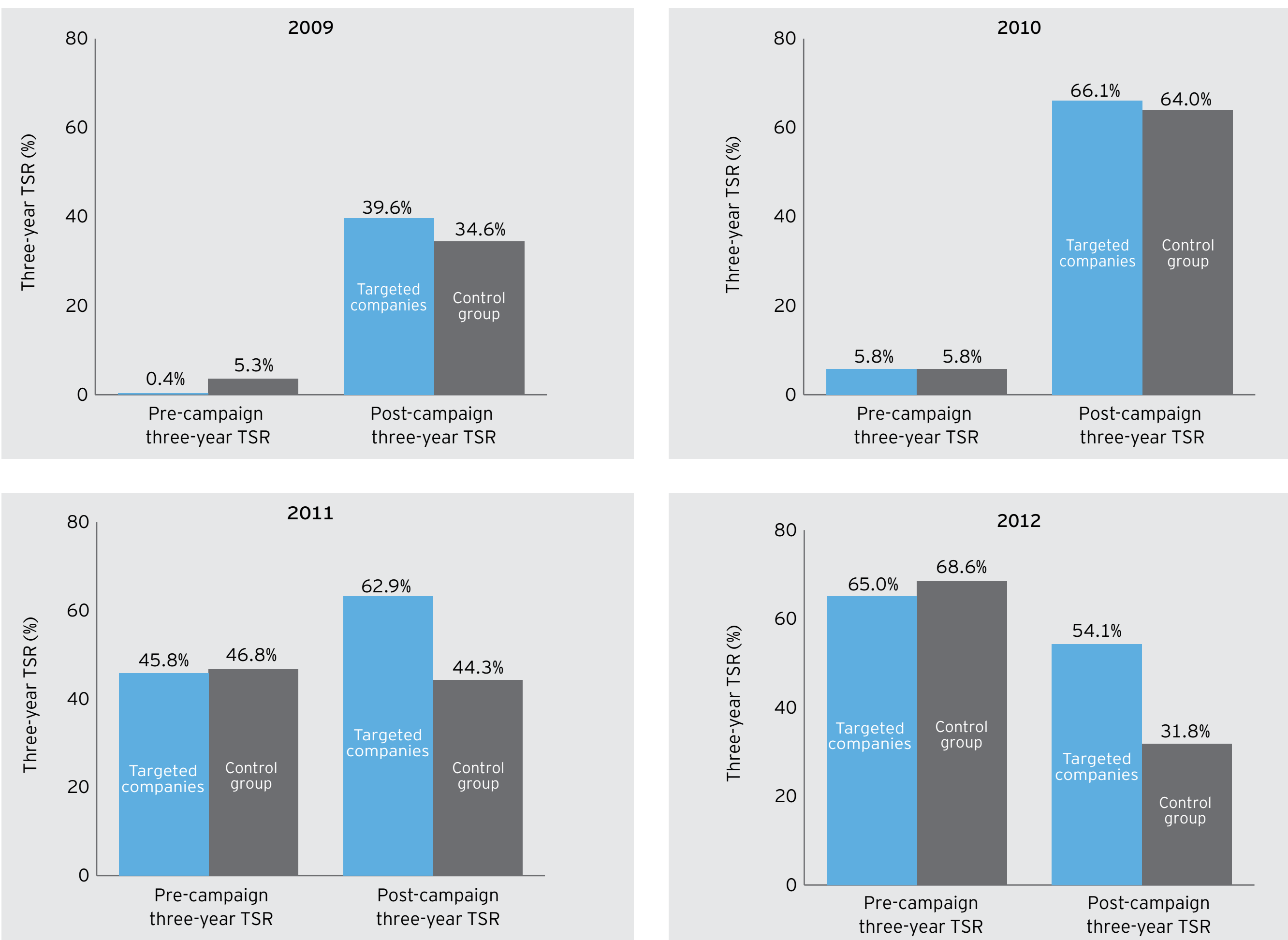
Shareholder activism drives higher shareholder value

EY-Parthenon looked at activist campaigns as reported by SharkRepellent from 2010-15 and analyzed before-and-after performance as measured by total shareholder return (TSR).

Key findings include:

1. The number of activist campaigns has nearly doubled over the past five years, with announced events growing from 181 in 2010 to 356 in 2015.
2. Activist investors tend to focus on large, asset-rich companies with revenues and margin growth that's slower than their sector peers, which creates opportunity to extract value through capital restructuring and longer-term business portfolio change.
3. As shown in the charts below, shareholder value was created faster in targeted companies than their sector peers over the same time frame, indicating that actions driven by activists are unlocking value.

Three-year TSR pre- and post-campaign (2009–12)

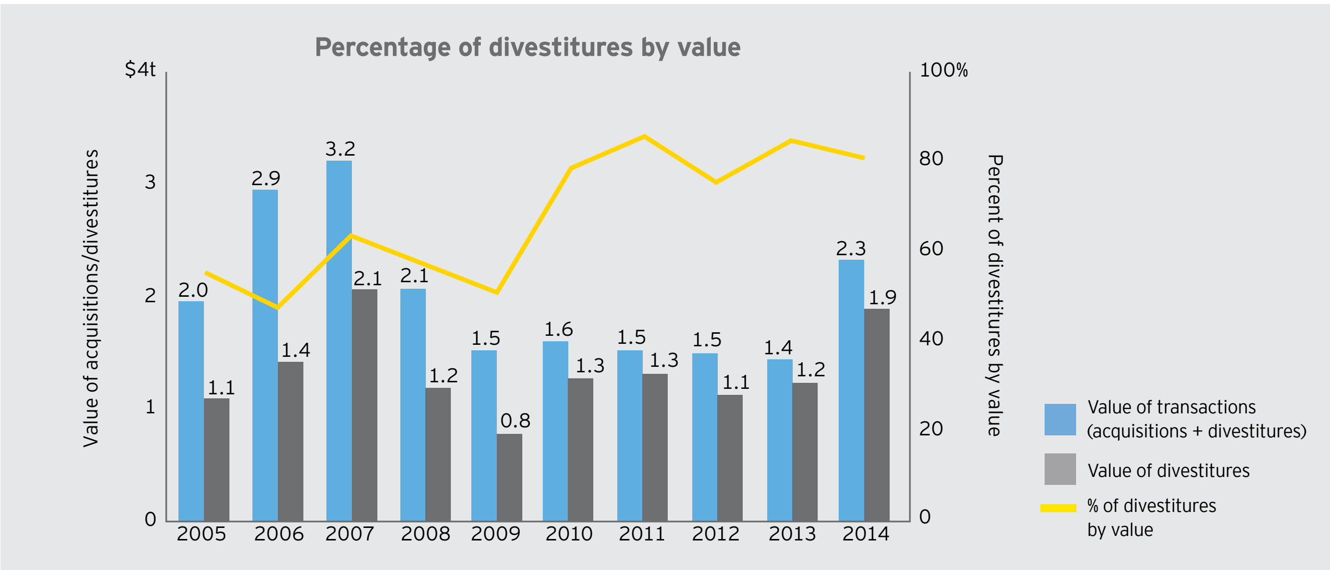


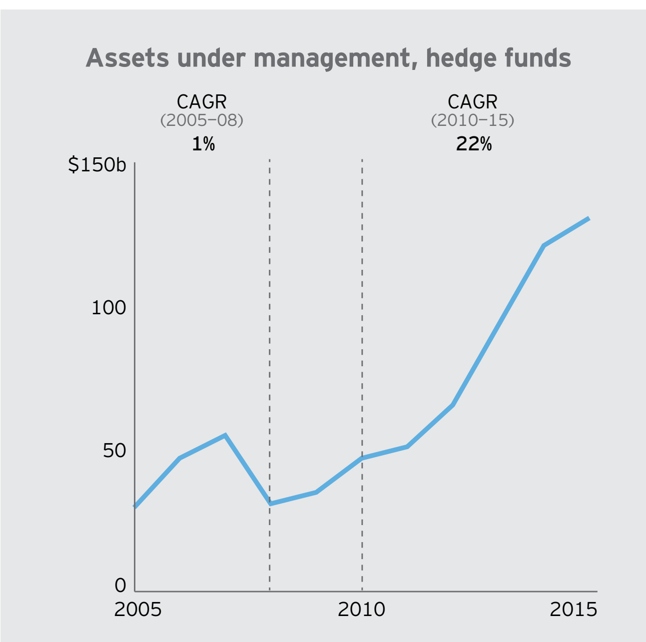
Notes: TSR for control sample from S&P Composite 1500 calculated using average initial campaign start dates for targeted companies; TSR has been calculated as per financial information updated 01/31/2017.
Source: SharkRepellent, Capital IQ, EY-Parthenon analysis, target group (n=528), control group (n=632 [2009], n=673 [2010], n=629 [2011], n=644 [2012])

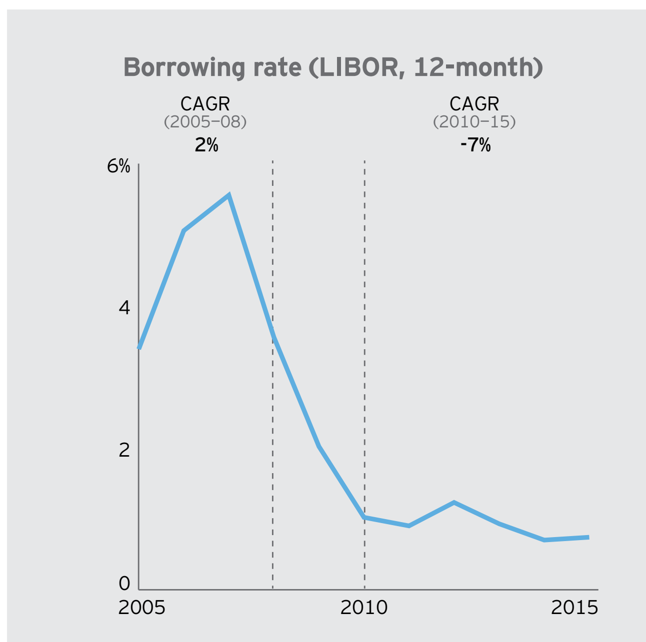
Activist campaign trends

A rise in activist campaigns appears driven by a hangover effect following a robust transaction period; enabled by a significant increase in assets managed by hedge funds and easy access to capital, companies targeted by activists are seeking to sell non-core assets.

Divestitures and spin-offs as a proportion of all transaction value increased from 55% before 2010 to 75% since 2010; corporates' key triggers for divestments are strategic and increasingly opportunistic, including a unit's weak competitive position in the market and an asset being viewed as non-core.







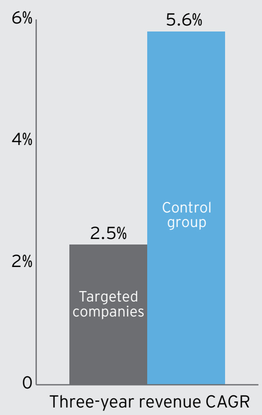
Note: Acquisitions include all transactions excluding divestitures and spinoffs; divestitures include transactions categorized as "divestitures" and "spinoffs."
Source: SharkRepellent, Norton Rose Fulbright, Capital IQ, hedge fund research, ThomsonOne, EY Global Corporate Divestment Study 2016, EY-Parthenon analysis

General company characteristics from activist campaigns

Activist-targeted companies underperform compared with their relevant sector peers on revenue growth and key profitability metrics during the years leading up to an activist campaign.

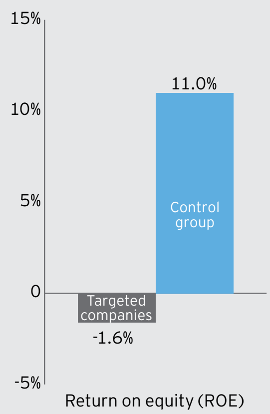
Targeted[1] vs. control group[2] (S&P Composite 1500, excluding targeted companies)

Revenue growth



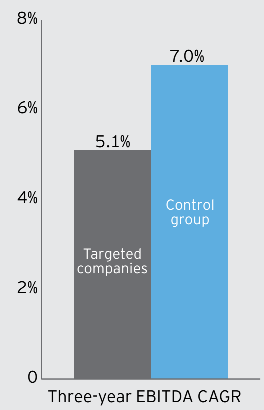
For the three years prior to an activist event, targeted companies demonstrate only a 2.5% CAGR, compared with a more than double CAGR of 5.6% for the S&P Composite 1500 (minus these targeted companies), our control group.

Return on equity



Targeted companies exhibit a negative ROE for the three years prior to an activist event: -1.6%. ROE for the control group is a vastly greater 11%.

EBITDA growth



Targeted companies also underperform the control group in terms of three-year EBITDA CAGR: 5.1% versus 7%.

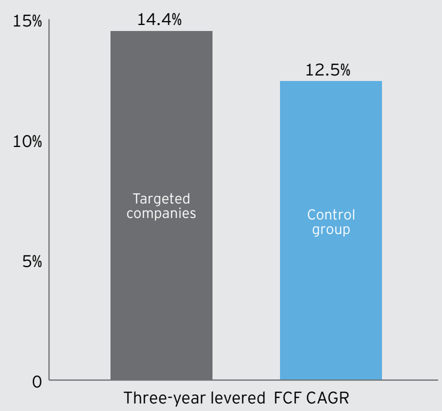
Notes: 167 targeted companies have been removed from the S&P 1500. Data is from 2009-12 time frame. Averages are of the 20th and 80th percentiles. Metrics have been calculated as per financial information updated 01/31/2017.

1. Target group: We extracted all shareholder activist campaigns announced during 2009-12 from SharkRepellent. Control group: Companies selected within each year's control group were determined based upon sector weights in target group, with companies selected from each of the S&P Composite 1500 sector indices.
2. Control group consists of companies constituting the S&P Composite 1500 during 2009-12, excluding those companies that were targets of activist investors during that period.

Source: Capital IQ, SharkRepellent, EY-Parthenon analysis, n=528 (targeted), n=1,333 (non-targeted).

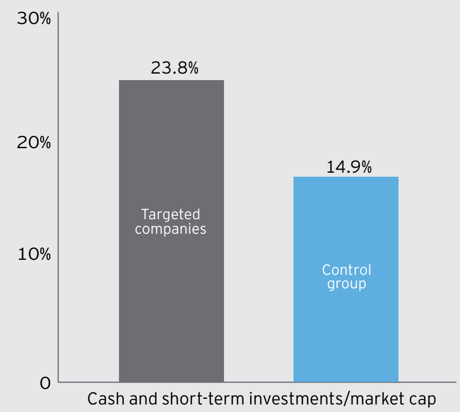
Targeted[1] companies seem better able to manage their cash flow compared with the control group[2] and had a significant amount of hard assets (cash and real estate).

Levered free cash flow (FCF) growth



For the three years prior to an activist event, targeted companies average a 14.4% increase in FCF, compared to only 12.5% for the control group.

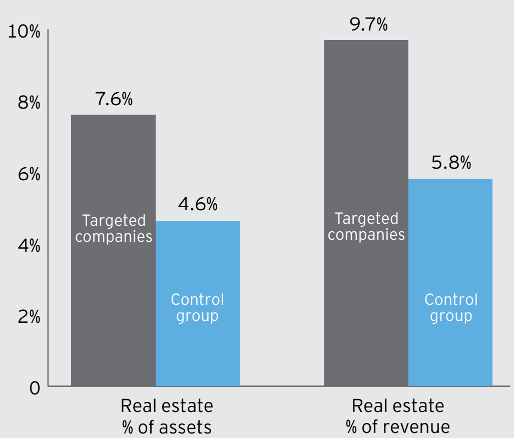
Cash and short-term investments/market cap



Targeted companies also tend to be noticeably more liquid than the control group. The percentage of cash and short-term investments over market capitalization at targets, 23.8%, is significantly more tempting to balance sheet activists than the control group's ratio of only 14.9%.

Real estate holdings

As a percentage of assets and revenue



The value of real estate under the control of targeted companies tends to be significantly greater than that of the control group. Consider these measures:

- *As a percentage of total assets:* targeted companies 7.6%; control group 4.6%
- *As a percentage of revenue:* targeted companies 9.7%; control group 5.8%

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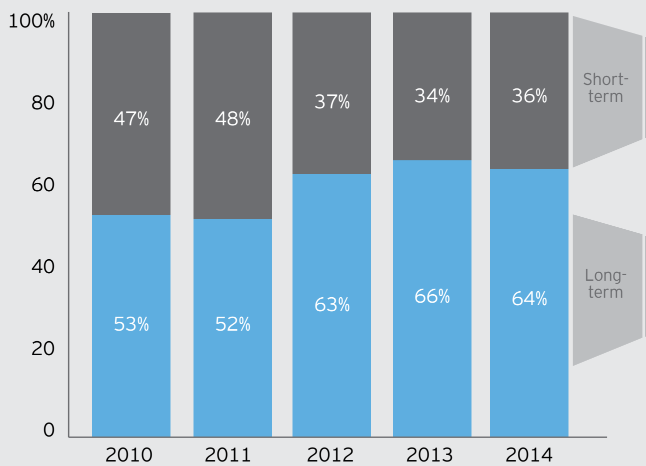
Source: Capital IQ, SharkRepellent, EY-Parthenon analysis, n=528 (targeted), n=1,333 (non-targeted).

A shift to long-term, collaborative campaigns is increasing TSR

As the investment horizon of shareholder activists increases, the activist campaign objectives move to longer-term strategies through business portfolio restructuring, changes in governance and operational efficiencies.

Investment horizon of shareholder activist objectives, 2010–14 (self-reported)



Category	Description	Pre-campaign three-year TSR*	Post-campaign three-year TSR*
Short-term campaign objectives	1. Capital structure 2. Sale of target company	15%	27%
Long-term campaign objectives	1. Business portfolio restructuring 2. Governance 3. Operational	53%	76%

Note: *Calculations are based on 2011 activist-targeted companies.
Source: SharkRepellent (n=1,677), EY-Parthenon analysis

Conclusion

Activism requires changes in governance going forward in order to maximize shareholder value and keep activists at bay

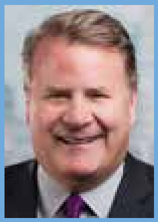
Companies need to take on the role of activist and proactively execute changes around governance in order to create greater shareholder value.

Become your own activist	‣ Appoint a board member to act like an activist ‣ Support this individual's efforts to make sure changes happen
Develop a 360-degree view of shareholder value and its key drivers	‣ Take a rigorous, ongoing view of shareholder value from an investor's perspective ‣ Have a real-time view of capital allocation and business performance ‣ Perform virtual carve-outs to understand the impact of value-eroding businesses ‣ Analyze potential strategies for trapped cash ‣ Evaluate debt structure and ability to increase leverage ‣ Assess working capital improvement opportunities
Adopt governance practices to address likely activist goals	‣ Review board composition and duration to achieve objectivity and a fresh perspective ‣ Seek a level playing field on the board with appropriate voting and nomination rights ‣ Align executive compensation and incentives with desired outcomes ‣ Provide a structure that allows for information transparency ‣ Review strategy and champion board efforts to create real and relevant change

Communicate frequently, consistently and transparently with key stakeholders

Executives and board members should communicate frequently and transparently with key stakeholders. Whether shareholders are active or quiet, knowing and utilizing activist strategies will help you remain competitive and strengthen your business for the long-term.

For more information about shareholder activism, please contact



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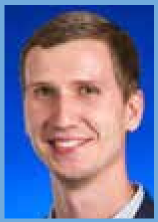

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About EY-Parthenon

Parthenon joined Ernst & Young LLP on 29 August 2014. EY-Parthenon is a strategy consultancy, committed to bringing unconventional yet pragmatic thinking together with our clients' smarts to deliver actionable strategies for real impact in today's complex business landscape. Innovation has become a necessary ingredient for sustained success. Critical to unlocking opportunities is EY-Parthenon's ideal balance of strengths — specialized experience with broad executional capabilities — to help you optimize your portfolio of businesses, uncover industry insights to make investment decisions, find effective paths for strategic growth opportunities and make acquisitions more rewarding. Our proven methodologies, along with a progressive spirit, can deliver intelligent services for our clients, amplify the impact of our strategies and make us the global advisor of choice for business leaders.

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