CORPORATE TRANSFORMATION SERVICES
FROM THE INSIDE OUT

Volume 3, Issue 16 – August 2, 2019

European Activists/M&A

Activists in Europe raise pressure on companies to sell underperforming divisions

Activist investors in Europe are increasingly calling on companies to carve out weak or non-core parts of the business, as they seek to drive shareholder returns amid slowing global growth and political uncertainty.

The number of activist campaigns in Europe has increased significantly in recent years, reaching a record of 58 in 2018, according to research by Lazard. Activists have also become more outspoken about what companies need to do to turn performance around, putting pressure on executives to demonstrably improve returns in a short space of time.

"When activists started turning their sights on Europe, historically, campaigns tended to be tamer than in the U.S. and they were primarily focused on changes to board composition," says Dhruv Sarda, Managing Director with Alvarez & Marsal (A&M)'s Corporate Transformation Services practice in London. "Now, they've added more chapters to their playbook - they're vocal on underperformance and increasingly putting pressure on management to divest underperforming divisions or parts of the business that no longer fit with the core strategy."

M&A is becoming an increasingly common feature of activist campaigns in Europe. The latest refresh of A&M's Activist Alert (AAA) model showed: in 2017 and 2018, 12 percent of demands made by activist investors related to potential M&A; however this increased to 17 percent during the first three months of 2019.

With global growth slowing – the International Monetary Fund this month cut its growth forecast for this year and next – companies may not have the time or resources to boost returns by improving performance in the timeframe demanded by activists. "Activists are looking for change in 12 to 18 months," says Mr. Sarda. "The amount of investment and time required to turn certain divisions around may not be in line with where the company needs to be."

A recent example in the UK is the specialist printing company De La Rue, which has issued multiple profit warnings and earlier this year agreed to sell its paper division after losing a key contract with the UK government to make British passports. The company is now under pressure from activist investor Crystal Amber to sell its banknote printing division.

Other UK companies vulnerable to an activist approach as a result of poor shareholder returns include Centrica, the owner of British Gas, Kingfisher, the owner of home improvement chain B&Q, and clothing retailer Next, according to a recent analysis by Canaccord Genuity.

The UK is still the biggest market in Europe for activists, and the weakness of the pound since the vote to leave the EU in 2016 has also made shares of British companies cheaper and more attractive as takeover targets to foreign buyers.

In continental Europe, Amber Capital has called on French water and waste treatment company Suez to "rotate out of mature assets" as part of a "clear strategic reset." In Germany, the CEO and chairman of industrial conglomerate Thyssenkrupp left last year, after pressure from activist funds Elliott and Cevian Capital. The company has now proposed spinning off its elevator division as a separate listing.

Of the 150 European companies most likely to be targeted by activists within the next 12 to 18 months, 23 are German and 20 are French, up from 17 in each country previously, according to the AAA model's findings.

To get ahead of a potential activist campaign, Mr. Sarda advises three courses of action:

The first is to undertake an objective Outside-In assessment of every business unit and then determine whether it has a place in the company's future – you need to evaluate the turnaround potential alongside other strategic choices such as divestment. "Some businesses that *were* core may no longer be so, and with the time horizon you have, businesses need to ask themselves, is it better to re-invest sale proceeds by investing in healthier divisions and bolt-on acquisitions instead?" he says.

Secondly, very often the assessment can pinpoint gaps or even weaknesses in the divisional management team. In such instances, "it may help to engage an interim leader to drive the transformation so that the necessary changes can start without having to wait for a permanent hire to be recruited", he adds.

Finally, he recommends that every company have a board member with M&A experience. "Boards need a full suite of experience," he says. "This experience is something private equity firms are good at building within their portfolio companies, but many public companies need to continue to build to be able to leverage it."

When A&M works with clients on transformation programs, with or without the pressure of an activist shareholder, "we bring an activist mindset," says Mr. Sarda. "We bring objectivity and a range of options – initially helping diagnose the root causes of under-performance and subsequently helping accelerate change."

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