Diligent Market Intelligence

Corporate Governance in Europe 2024

in partnership with

WHITE & CASE

The UK market: Unlocking value through M&A

An interview with Tom Matthews, Sonica Tolani and Alex Woodfield, partners at White & Case.

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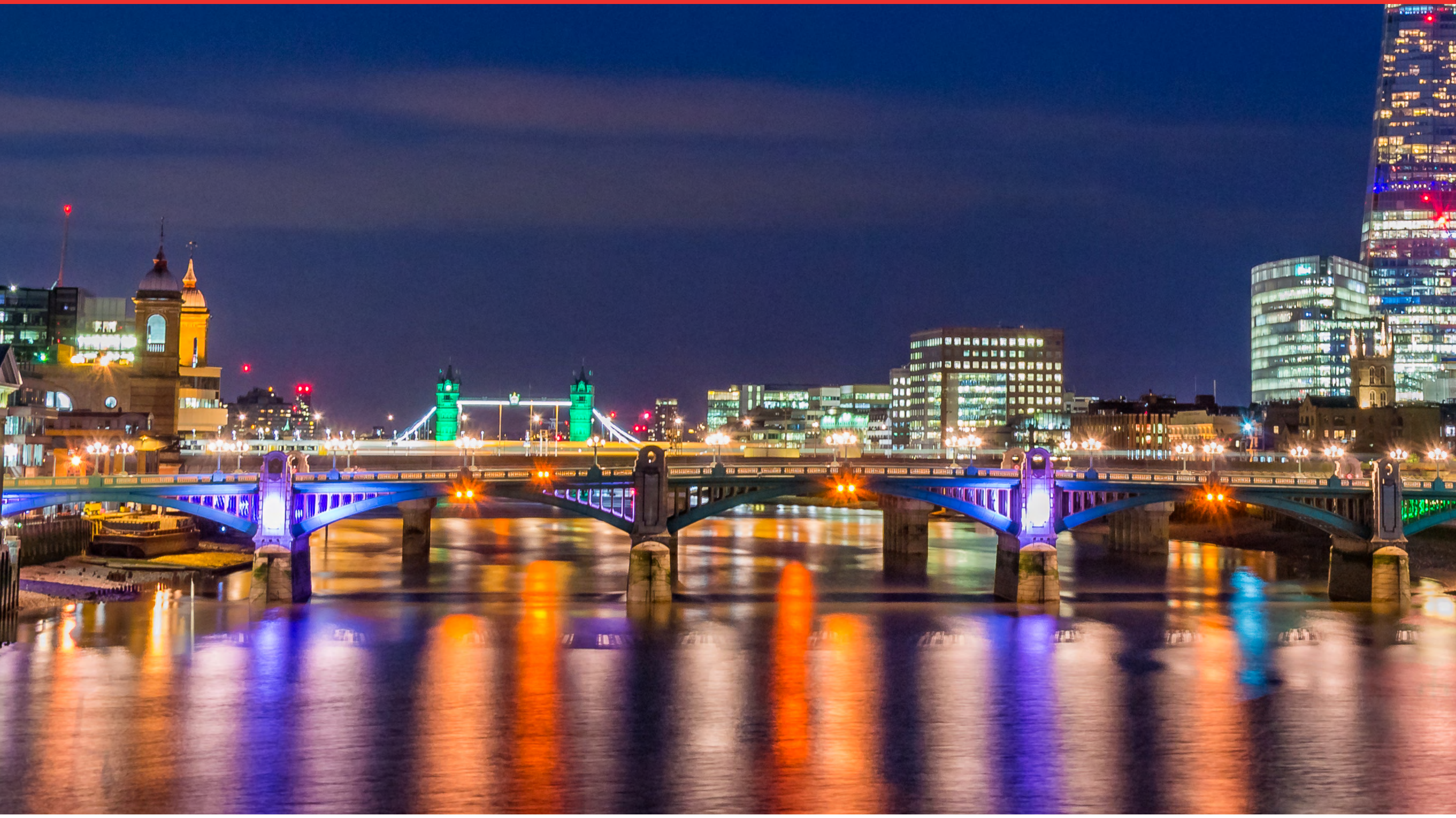

> "We are seeing a renewed focus on M&A-related activism campaigns. Break-ups of large conglomerates have once again become a key activist campaign thesis in the U.K."

Are any specific demands being more frequently adopted in activist campaigns involving U.K. companies?

Tom Matthews (TM): We are seeing a renewed focus on M&A-related activism campaigns. Break-ups of large conglomerates have once again become a key activist campaign thesis in the U.K. Such campaigns can allow shareholders to extract untapped value through various methods, including spin-offs of undervalued profitable businesses or the sale of business lines outside a group's core business.

Sonica Tolani (ST): In light of the continuing strength of U.S. markets and the perceived under-valuation of U.K. companies, there have been, and we expect to see further, activist-led campaigns pushing certain companies to either add a U.S. stock exchange listing or move their primary listing to the U.S. Such a campaign may also form part of a break-up thesis, e.g., an activist may push for a division of a company with strengths in the U.S. being spun-off and listed in the U.S.

Some U.K. companies have advocated for increasing CEO pay packages in line with U.S. peers, in a bid to remain competitive. How might this impact investor engagements pertaining to pay?

Alex Woodfield (AW): The U.K. public markets have recently seen a growing debate regarding the impact of remuneration on companies being able to hire and retain top executive talent, in the context of maximizing the attractiveness of listing in the U.K. Investor associations have, in turn, been suggesting potentially greater flexibility.

Activist investors have often considered the remuneration models traditionally preferred by U.K. institutional investors to be insufficiently aligned to shareholder returns, whilst inhibiting companies' ability to adequately reward exceptional performance, and that companies are reluctant to depart from such traditional models. With signs that some boards are being emboldened by the public debate, we expect to see a renewed push from activists on this topic.

> “Whilst ESG remains high on the agenda of most boards, environmental activists continue to push for greater action.”

2022 saw lots of first-time activists, did you see this trend continuing in 2023?

TM: In Europe, a record 31 new activists launched public campaigns during 2023, not only a new high, but over double the figure for 2022. Two-thirds of these first-time European campaigns were M&A-related, and we would expect this trend to continue with improving M&A markets.

This emergence of new activists reflects an ever-expanding universe of investors engaging in shareholder activism. We continue to see experienced activist investors entering new markets, the establishment of new activist investment funds and the adoption of activist strategies by other market participants.

ST: Amidst the growing universe of activist investors, we are also seeing more activists considering participating in or financing takeovers themselves. Whilst markets as a whole have performed more strongly in recent months, some sectors continue to suffer from depressed or stagnant valuations. This may incentivize activists to defensively bid for companies to avoid crystallizing losses in the event of a sale to a third-party bidder.

How have ESG engagements evolved in the U.K. in 2023 and early 2024?

AW: Whilst ESG remains high on the agenda of most boards, environmental activists continue to push for greater action. We anticipate those activists may focus more on non-litigious engagement with U.K. companies (including shareholder resolutions), a potential consequence of a recent court defeat (including an adverse costs award) for environmental advocacy organization ClientEarth.

By contrast, there are some signs of skepticism towards companies' environmental strategies, including assertions by certain activists that certain companies' environmental strategies need to afford more weight to shareholder value. Whilst we do not expect skepticism in the U.K. and Europe to be as vocal as the anti-ESG movement in the U.S., activist investors advancing pro-environmental campaigns seem likely to be rare.

The German market: An activism renaissance

An interview with Frederic Wuensche and Dr Thyl Haβler, partners, White & Case.

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> Industrial companies continue to be under pressure due to weak profit margins caused by high personnel and energy costs. Their capital allocation and cash generation remain under particular scrutiny.

Over the past year, German companies proved increasingly popular targets among shareholder activists. What might have driven this increase in activity?

Dr Thyl Haβler (TH): Lower valuation multiples, depressed price to earnings ratios and, accordingly, increased pressure from shareholders to maximize returns, offer greater potential for activist campaigns in undervalued targets in Germany, including seeking value accretive changes. Other key drivers have been the rising cost of capital for many companies, as well as supply-chain issues and asymmetric dependencies from foreign markets.

These factors have highlighted needs for reorganizations, spin-offs, M&A and other corporate transformations. Activists are anticipating this and have increasingly used these factors as the basis for their campaigns.

What key developments have you recently observed in shareholder activism in Germany?

Frederic Wuensche (FW): 2023 was one of the most active years ever for shareholder activism in Germany. Campaign focuses included leadership changes, operational enhancements, changes in strategy, improved capital allocation and portfolio actions to increase shareholder value. In addition, some activist shareholders demanded special audits to investigate management actions.

There were high-profile break-up campaigns at Bayer, Fresenius and Brenntag. At Bayer, several activist investors (including Inclusive Capital, Bluebell Capital Partners and Elliott Investment Management) demanded its break-up into separate pharmaceutical and agrochemicals companies, as well as replacing the CEO. Although the break-up has not been implemented (but is still under discussion), the replacement of the CEO was ultimately successful, and even supported by institutional investors.

Additionally, activist investor Jeffrey Ubben was elected to the sustainability board of Bayer and was further elected to the supervisory board at the 2024 annual meeting, again supported by institutional investors.

At Brenntag, PrimeStone Capital and Engine Capital successfully led a campaign to break up the company, with Brenntag announcing in December that it would reorganize its business into two independent divisions, starting in 2024.

> “Lower valuation multiples, depressed price to earnings ratios and, accordingly, increased pressure from shareholders to maximize returns, offer greater potential for activist campaigns in undervalued targets in Germany.”

TH: A recent noteworthy trend is that activist shareholders have increasingly demanded special audits to review management actions and to investigate alleged fiduciary breaches as part of their campaigns.

At Deutsche Wohnen’s June 2023 annual meeting, Elliott Investment Management demanded a special audit to investigate a two billion euro ($2.1 billion) loan from Deutsche Wohnen to its shareholder Vonovia, which, according to the activist, was granted on unfavourable, non-market terms. Ultimately, Elliott was not successful with its demand, but the engagement nonetheless represented a new activism campaign focus.

Are there specific sectors that are targeted by investors?

FW: In 2023, activist shareholders focused mainly on four sectors: industrials, consumer goods, technology and healthcare. In particular, industrial companies continue to be under pressure due to weak profit margins caused by high personnel and energy costs. Their capital allocation and cash generation remain under particular scrutiny. The chemicals sector is also seen as a preferred target for activist shareholders due to low valuations and significant pressure to cut costs and implement structural changes.

Are activists in Germany increasing their focus on ESG issues?

TH: There was a slight decline in ESG-related campaigns in a challenging market in 2023 as investors placed a renewed focus on metrics such as margin growth, cash generation and return on capital. Nevertheless, with the importance of sustainability regulations growing, it is unlikely that the wider trend towards sustainable shareholder activism will decline in the near future.

We expect that activist shareholders will seek to put ESG items on the agendas of annual meetings more frequently. However, questions have arisen concerning ESG measures falling within the competence of the management board. This was highlighted in a 2023 decision, where a court clarified that shareholders could not require Volkswagen to include a shareholder proposal on its 2022 proxy ballot to enhance the board’s reporting obligations regarding climate-related lobbying.

The French market: ESG gains traction

An interview with Diane Lamarche and Saam Golshani, partners, and Simon Martin-Gousset, associate, White & Case.

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> “The most publicized activist campaigns recorded in France were related to ESG topics, in particular governance or climate change issues.”

What trends have emerged from activist campaigns in France over the past year?

Diane Lamarche (DM): In 2023, the number of public activist campaigns in France remained stable. However, the practical resolution of many conflicts occurred privately, often through closed door engagements with directors and executives of companies away from the view of public markets.

Although, in recent years, there has been a decline in judicial activism in France, following Amber Capital’s high-profile campaign at Lagardère in 2021, the courtroom remains a tool available to activists targeting French issuers.

Saam Golshani (SG): Over the past year, the most publicized activist campaigns recorded in France were related to ESG topics, in particular governance or climate change issues. For example, carehome operator Orpea faced litigation initiated by minority shareholders in 2023, opposing its financial restructuring plan and governance amendments.

Similarly, TotalEnergies received a climate resolution from environmental advocacy group Follow This at its 2023 annual meeting, which urged the company to establish greenhouse gas emission targets aligned with the Paris Agreement. The proposal received 30.4% support.

Last year, a proposed regulation mandating “say on climate” votes at French public companies was withdrawn shortly before being enacted. Are “say on climate” proposals an impactful tool in holding local companies to account?

Simon Martin-Gousset (SMG): The Green Industry Bill (Loi Industrie Verte) amendment, which was withdrawn in October, aimed to introduce new obligations for listed companies, in particular the requirement for boards of directors to develop a climate and sustainability strategy to be submitted to shareholders for an advisory vote every three years, and prepare an annual report on the implementation of this strategy.

There is widespread consensus in the French market that it would be a mistake to enact “say on climate” legislation, given it would add an additional legal burden on French listed companies.

Notwithstanding this, over the past four years, the practice of “say on climate” proposals has gained traction in France, and whilst the number of resolutions has decreased slightly in the past year, proposal approval rates increased significantly. In 2023, the climate strategies of nine French companies (including Covivio, Icade, Schneider Electric, Klépierre and TotalEnergies) were submitted and approved

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by shareholders. Dissident climate resolutions, such as that proposed by Follow This at TotalEnergies’ May 2023 meeting, have also emerged, although they were largely unsuccessful.

Have there been other noteworthy regulatory developments in France, pertaining to investor stewardship?

SG: Shortly after the promulgation of the European Union’s Corporate Sustainability Reporting Directive (CSRD), French markets regulator Autorité des marchés financiers (AMF) called on issuers to strengthen shareholder dialogue by presenting their climate strategy at each general meeting and facilitating discussion.

However, AMF also stated it does not have authority to assess the acceptability of draft resolutions which shareholders request to be included on general meeting agendas. Such sensitive topics are highly likely to give rise to litigation before the French courts in the future.

DM: In December 2022, revisions to the AFEP-MEDEF Corporate Governance Code of Listed Corporations were enacted. These revisions aimed to prioritize Corporate Social Responsibility (CSR) strategies, particularly concerning climate issues, although it should be noted that the revisions do not mean the code officially endorses the principle of “say on climate.”

These revisions provide that boards, in collaboration with executive management, should establish multi-year strategic objectives in these areas, with a focus on climate. Executive management are required to submit measures to the board implementing this strategy and to inform the board of the results achieved on an annual basis.

On climate-related issues, this strategy is accompanied by precise objectives for different time frames. The board must annually review the results achieved and the relevance, if any, of altering the plan or amending the objectives. The climate strategy and the main actions undertaken to this end must be presented at annual meetings at least once every three years, or where there is a significant change in the strategy. The revisions also emphasise the incorporation of CSR criteria into executive remuneration.

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