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Deloitte M&A Views podcast:
Activist investing is back. Is your board ready?

Rob: Welcome to Deloitte's M&A Views podcast, Where we tap into what Deloitte professionals know about making smart, strategic M&A decisions. I'm Rob Dieterich. Today, on the board agenda: Activist investors. We have with us Joel Schlactenhaufen, a principal in the Merger and Acquisition Consultative Services practice at Deloitte, And Chris Ruggeri, a principal at Deloitte Transactions and Financial Advisory. Our topic is the role directors can play as activist investors get back to work post-pandemic.

Well, Joel and Chris, thank you very much for joining me today to talk about boards and activist investing. I think a good starting point for our discussion has to be acknowledgment that 2020 was a weird year for everything, but it was a relatively quiet year for activist investing. The pandemic, for at least a while, shut down activist campaigns for the full year, even though it got going a little bit, in the latter half. We had the fewest activist campaigns we've seen since I think 2015, according to the data from Activist Insight. But we're in a new year, and the underlying rationale for activism, that investors can identify opportunities to boost value, hasn't really changed. So let me just start and ask the obvious question. Have activist investors, gone back to work this year? Are we expecting to see more in the coming months or are we already seeing a step-up in activity?

Chris Ruggeri: Thank you, Rob, and a pleasure to be here. There's quite a bit of capital that has flowed into activist funds. And what that means is that the activist community are exploring opportunities to put that capital to work. I think now that with the vaccine infiltrating, into our communities, we're going to see activists become a bit more confident and continue to look for opportunities to uncover value.

Rob: Yeah, and I think one of the other things that we need to talk about is the fact that deal-making activity certainly has picked up. And M&A campaigns are a really important mainstay for activist investors. Are they not? Maybe, Joel, you want to take that question?

Joel Schlactenhaufen: Yeah, Rob. Thanks a lot. And I'm happy to be here as well. And that's exactly right. One of the key tools for activist investors is to drive portfolio changes or even things like breakups of companies and those types of things to release shareholder value. And we see that activist investors are going to continue to use M&A transactions as a tool to release shareholder value. And we expect that to continue, just as the trend of increased M&A activity is continuing into FY21.

Rob: So we've got the backdrop, which is that activists, after a quiet period, are going to be back—are back. So let's bring that around to implications for directors. What should the board of directors be certain they're doing? One thought here is just the basics that they need to be acknowledging that activists play a valuable role and then engage proactively with the ideas and strategies that an activist campaign might raise. Chris, does that sound like the right starting point?

Chris Ruggeri: Sure. I think any type of market shock or dramatic change in the business landscape creates an environment—a fertile environment—for activism because it disrupts business models, it impacts performance. I think it's important that directors approach this question through the lens of an activist. How has the current business environment created opportunities for companies to accelerate growth through M&A? That can sometimes, and increasingly it's been attracting activist attention. So I think my best advice for directors is, again, think like an activist. How has the business environment changed? And has that created any gaps or vulnerabilities for your company that might attract an activist?

Rob: Okay, well, let's look closer at that idea of thinking like an activist or, put another way, having an activist mindset. What are the different categories you need to be looking at?

Chris Ruggeri: There are a vast range of activist strategies. So in the aftermath of the—the immediate aftermath of the financial crisis—we saw many companies that had excess liquidity. We saw business models that were no longer competitive and activists were focused on looking at companies and looking at underperforming businesses and prodding companies to perhaps release that value or return that value through some type of a capital markets or M&A transaction. Just immediately prior to the advent of COVID-19, we saw activists focused on growth. So looking at, how can they work with companies and their boards to accelerate growth through, again, using M&A as a candidate for growth acceleration. I think now in the aftermath of COVID-19, we see all of those strategies being considered. We're also—I think we've seen a proliferation of SPACs. I expect to see activist activity focused on SPACs.

Rob: One thing that occurs to me that you were saying there is the different pieces that you were identifying, that there may be a balance sheet strategy, that it's the level of liquidity that the company is maintaining, or underperformance, or just differences in views on what the strategy should be in the current environment, because things have changed. All of those are things that have only been exacerbated, or certainly have been put back on the table in some cases, over the past year. Right?

Chris Ruggeri: Absolutely. And something that we're seeing right now that I think is very interesting is ESG. Now ESG has gone from being a, somewhat of a fringe consideration in business decision-making to really becoming central to all business decision-making. And I think that what we're starting to learn and observe is that those companies that are applying ESG principles as part of their normal business decision-making process are seeing—there've been a few studies I've seen recently where these companies are generating better performance than the average. So I think that this ESG is going to continue to figure prominently into not just capital markets transactions, but how activists are pursuing opportunities.

Rob: Chris, can you help me unpack this? Because ESG is shareholders being activists on certain issues that they care about and also hoping to see greater performance from a company because of it. But are there also places where what we sort of traditionally have been thinking of over the last decade as activist investors, the ones that launched campaigns or M&A-related campaigns and so forth, are they always going to be on the same page?

Chris Ruggeri: There clearly is a diversity of opinion. But I think if there's a correlation between, let's say, environmental and climate change and attaining net zero in the future, that translates into faster revenue growth, because you're better aligned with customer expectations, that then translates into higher profitability and bottom line performance, it's going to attract the attention of the activist community. Because they're going to be looking for those companies that perhaps might be laggards in their industry, where customers are voting with their dollars and their feet. So that's one of the things that I think, to your point, you know, there's a decided trend here. And I think what ultimately is going to have a profound impact is, investors and the decisions they're making. We've seen some of the largest investors in the world, the BlackRocks, the Vanguards, the State Streets, come out and make statements about their expectations around ESG.

Rob: One thing that occurs to me that we should definitely talk about is this—beyond just thinking with an activist mindset, there's also just sort of this necessity of boards, really understanding and communicating well with management.

Joel Schlactenhaufen: Obviously, the communication between boards and management is critical in all ways, shapes, and forms. The challenge that that alliance between the board and management has to think about is just, are they bringing in, collectively, enough alternative perspectives? Are they challenging each other? And some boards do that very well with management teams, and management teams are very open to that. And in other cases, there's tension and it may not be as open and collaborative in nature. But the symbiosis between board and management that works very well is where you see those lines of communication open and very frank conversations and discussions taking place. And so we would encourage that.

Rob: Chris, you mentioned, SPACs. One thing that occurs to me about SPACs is that as SPACs do their acquisitions and they create newly public companies, those companies quickly become targets for activist investors, especially if they're maybe not quite ready to be public and they have a few public stumbles. Are there other issues we should be thinking about related to activism and SPACs?

Chris Ruggeri: Well, I, I think that is absolutely the case. And also, SPACs have a responsibility to—and there are time limitations that they have in order to put the capital on their balance sheet to work. So I think that, in and of itself, will attract scrutiny and attention. And then once those investments are made, typically again, that it manifests in an M&A environment, the activist community will likely—it will draw the attention of the activist community that will be evaluating the performance of those investments.

Rob: So are you saying, you could actually see a situation where an activist investor gets involved with a SPAC that has gone through its IPO but hasn't done a transaction yet?

Chris Ruggeri: Absolutely. A my good friend Joel knows he and I have worked on many transactions together. Going from concept to execution is a leap. And what may look good conceptually needs to be proven out in fact. I think if I were a board director of a SPAC, this is an area that I would be focused on.

Rob: Joel, any thoughts on SPACs before we move on?

Joel Schlactenhaufen: I'm glad Chris brought this up. And Rob, we've talked about this before, and we've proven out, that the success of most transactions resides in the execution or falls down in the execution. And so, regardless of whether it's a SPAC, although they do provide a good mechanism to this study, you know, the success of execution, you know, post transaction, the execution is absolutely critical. And as a board member, there's sometimes a tendency to assume that management, in their function as management, has everything under control.

Rob: Right. So the thought that the board's role is more strategy and less oversight of execution or oversight of the nuts and bolts of value capture post-transaction, it can be risky.

Joel Schlactenhaufen: Right. And in fact, having a good communication and relationship with management that enables very tight questioning and oversight of the actions that are being undertaken to successfully integrate or separate, or all of the executional steps around a specific transaction is critical.

Rob: Okay. That all makes sense. We're just about out of time. Joel, anything further that I haven't thought to bring up yet?

Joel Schlactenhaufen: I think, as a board member, and thinking about some of the questions you had around activism, there's a DEI component that is new and different. I think we don't know all the ways in which it's going to play out from a board member's perspective. But we do know that it's not a fad, and it's important. I think there's an element there that people should understand, as board members, how management is looking at DEI. If you're looking at other companies in diligence, as management, understanding the DEI landscape and the implications for maybe differences that exist between companies when you're in that type of environment, I think will be more and more important from a value perspective.

Rob: That is a really interesting point. And this has been a really interesting conversation, but I think we'll leave it there. And I just want to say, thank you to Chris and to Joel for joining me. It's been a lot of fun to talk this through.

Joel Schlactenhaufen: It's been a pleasure. Thank you, Rob. Appreciate it.

Chris Ruggeri: Thanks, Rob.

Rob: This has been Deloitte M&A Views. We've been talking today with Joel Schlactenhaufen, a principal in Merger and Acquisition Consultative Services at Deloitte. And Chris Ruggeri, a principal at Deloitte Transactions and Financial Advisory. I'm Rob Dieterich. Thank you for listening.

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