

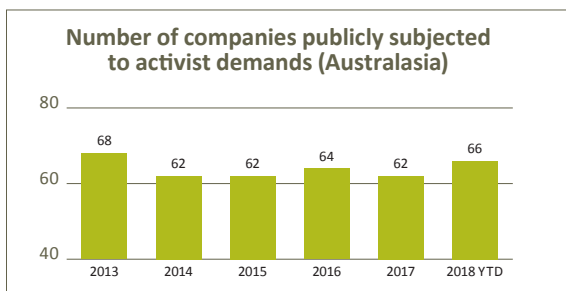
ACTIVISM AUSTRALIAN STYLE

The level of activism in Australia is second only to the USA, yet our experience of it is very different to anywhere else in the world.

Globally the number of companies subject to activist demands has been falling for the past three years, from its peak of 887 in 2016, to 854 last year and so far this year 811. Interestingly though, the number of activists has been rising, with the first 10 months of 2018 already exceeding the record of 714 in 2016, at 731.

So, fewer companies globally are being targeted but more activist shareholders are working together to bring an action.

It's not quite the same story in Australia where the number of companies subject to activist demands has been relatively steady since 2013, ranging between 62 and 68 each year. Although, if things pick up in the remaining weeks of the year, 2018 may well set a new record. Where Australia is consistent with the global trend, however, is the rising number of activists. This exploded in 2017, increasing by 44% and this year is on track to rise another 20%.

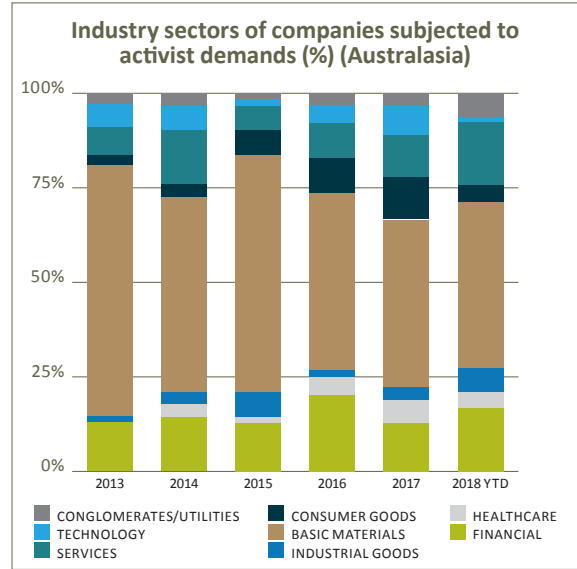
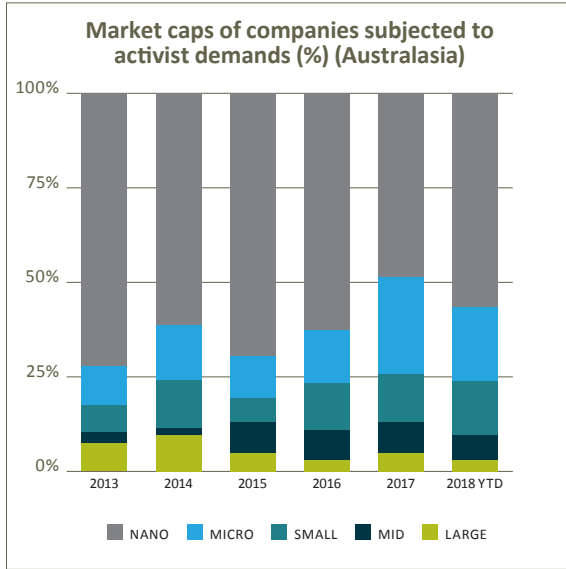


In Australia there has been no noticeable increase in activism, in terms of the number of companies being targeted, but there are lots more players joining in the game.

One explanation for this trend in Australia is the increasingly popular use of s249D¹ or s249F in the Corporations Act with multiple individuals, companies or institutional investors often being named (Concerned Shareholders) as party to an action.

However, apart from high profile activist campaigns targeted at companies in the top 100-200, such as Elliott's tilt at BHP, Ariadne's campaign against Ardent Leisure and Premier Investments ongoing proding of Myer, most observers would struggle to understand why Australia is regularly cited as the country that is home to the most activists after the USA.

1. Shareholders collectively possessing five percent or more of voting rights have the power to request directors to call a general meeting (and the directors must do so). They then give the company notice of a resolution they propose to move, and give the company a statement to be distributed to all members.



Size Matters

A unique feature of Australian activism is that the vast majority, 75-80%, of companies targeted have a market cap of less than US\$250m (nano and microcap) and most of those have a market cap of US\$50m or less. This compares with the global experience where nano and microcap companies would account for less than half of all activist campaigns, at around 40%.

The most noticeable change in this market over the past three years has been the increase in small to mid cap companies (US\$250m-\$US10bn) being targeted, which roughly represent the equivalent of the ASX31-300. These now account for 20% of all actions, close to double that in previous years.

A defining feature of Australian activism however is that large cap companies (+US10bn), or the equivalent of the ASX top 30, are rarely targeted (4% on average) and even then the actions tend to be focused on attempts to change the constitution or force the resignation of certain directors. Only Elliott Management's very public campaign to encourage the BHP board to abandon its dual-listed share structure, spin off its US petroleum business and launch a buyback program, could be considered an example of a true activist campaign.

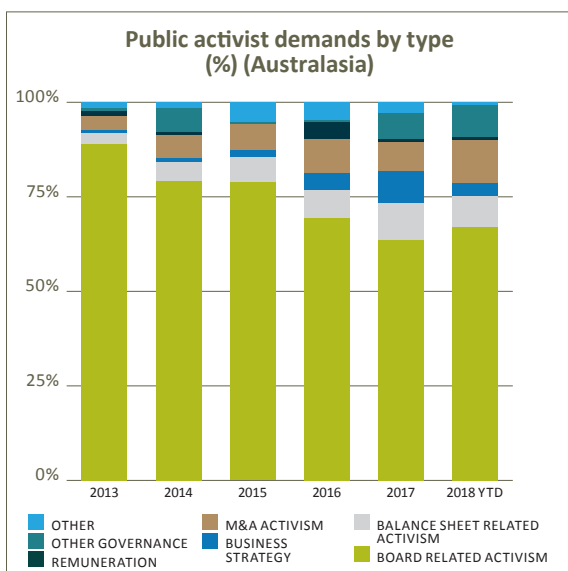
By contrast large caps would account for around 20% of activists' targets in the rest of the world.

Sector Counts

Resources stocks have consistently dominated the activist space in Australia although their share has declined from 66% in 2013 to around 44% in the last 2-3 years.

The dominance of the resources sector reflects the composition of the ASX where 44% of its c.2000 listed companies are energy and materials stocks and of these, 500 companies have a market cap less than A\$25million.

Stocks in the **financials** sector have generally held second place, accounting for on average around 13% of activist campaigns. However the **financials and services** sector are both worth watching with activity levels accelerating in 2018 to each average 17%.



Where do Activists focus their Demands?

Board related activism is, and has consistently been the dominant theme in Australia. Today it accounts for over two-thirds of activist demands and over the past year has seen a resurgence in popularity, largely at the expense of business strategy activism. A similar pattern is evident, for example, in the Canadian market where board related activism is on the rise but at the expense of M&A activism.

In Australia **M&A activism** ranks a very distant second to board related activism (11%) and 'Other Governance' concerns, while attracting increased attention in the last two years, ranks an even more distant third (8%).

This is in contrast globally where 'Other Governance' issues has achieved increasing prominence (15-20%) in the past three years while M&A activism has been in decline (12-14%). Board related activism consistently accounts for just under half of all global actions.

Nano and microcap stocks in the resources, financials and services sectors typically account for 75-80% of activism in the Australian market where campaigns are heavily biased towards seeking changes to the board.

Is Australian Activism really that Different?

It is one thing to differ from the US or the global average across a range of metrics, but analysis of activist trends in other regions and countries suggests that the shape of activism in Australia is indeed very different. This is best illustrated by comparing Australia with Canada, an economy which also depends on its major resources in mining and agriculture for growth and has around 4,000 listed companies on its two major exchanges (TSX and TSXV) of which 40% are emerging companies predominantly in the mining and energy sectors.

The tables below compare the number of companies targeted on average according to size and sector over the past 5 years in Australia, Canada and the USA.

US\$	Average 2013–2018		
Market-Cap Category	Australia	Canada	USA
Large Cap: > \$10bn	5.3%	15.8%	23.9%
Mid Cap: \$2bn–\$10bn	6.6%	14.6%	16.8%
Small Cap: \$250m–\$2bn	11.6%	18.7%	23.2%
Micro Cap: \$50m–\$250m	15.9%	16.0%	18.0%
Nano Cap: < \$50m	60.7%	34.9%	18.1%

Despite the similarities with Australia, there is little evidence of market cap bias amongst activists targeting Canadian stocks, apart from the slightly higher weighting towards nanocaps, albeit still half the experience of Australia.

	Average 2013–2018		
Sector	Australia	Canada	USA
Basic Materials	51.2%	36.4%	11.8%
Financial	15.3%	21.3%	20.5%
Services	11.1%	13.5%	23.3%
Consumer Goods	7.5%	3.8%	7.7%
Technology	5.6%	10.7%	16.7%
Industrial Goods	3.9%	6.0%	7.1%
Healthcare	3.6%	7.0%	10.0%
Utilities/Conglomerates	1.9%	1.2%	2.7%

Australian and Canadian activists are predisposed to the resources, financials and services sectors albeit with different degrees of emphasis, with c.70-80% of all activity occurring in these sectors.

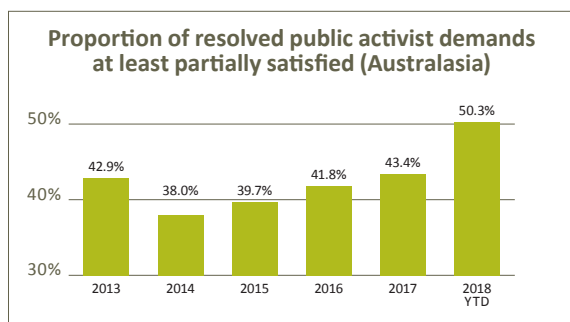
In the USA, however, activity is much less concentrated with 60% of activism occurring in their top 3 sectors – services, financials and technology.

Where to from here?

Analysis of the trend over recent years suggests that Australia's geographic distance from the USA has helped keep the predicted wave of US activist capital from reaching our shores. That is not to say that US funds are remaining domestically focused. In 2018 parts of Europe and Asia, particularly France and Japan, have been subject to increased attention from US activists. The first quarter of 2018 also registered the largest amount invested by US activists in European companies (US\$5.4bn) in 5 years.

In Australia it has mainly been local activists and shareholders who have taken on the task of agitating for change when company performance or governance has failed to meet expectations.

They are also getting progressively better (50%) at having their demands met compared to North American activists where the success rate has been falling steadily for the past 6 years and now sits at 42%.



Australia has a very activist friendly legal and regulatory environment, so while the locals are getting increasingly better at what they do, the question still remains, how long will it be before the US players decide to join the party? In that event it will be those segments of the market that have so far been immune to activism that will be most at risk, companies with market caps above A\$500m, particularly large caps.

Data for all charts and tables supplied by *Activist Insight*

Top tips for being Activist Ready

How does a company know whether it is a likely target for activist attention and is there anything it can do to prepare itself? An analysis by Activist Insight of US companies targeted by activists between 2014 and 2016, identified a number of characteristics which enable companies to assess their relative vulnerability to short to medium term (9 months) activist investment. While we have demonstrated that activism in Australia has some very different characteristics to that in the US, the four strongest predictive variables from this analysis are worth noting given that intuitively they make sense and are also easily monitored.

- existing activist ownership on the register
- a high level of institutional ownership
- one year underperformance relative to peers measured by TSR
- one year underperformance relative to peers measured by ROE

The most significant takeout from the last two measures is that companies suffering a short term set back in profitability or share price performance, despite an otherwise strong track record, are the ones most likely to be in the cross-hairs. So what can companies do to ensure they are 'shareholder activist ready'?

- build strong lines of communications with major institutional investors and the broad base of shareholders;
- monitor the share register for early signs of activist investment;
- periodically survey institutional shareholders, including using independent research, to ensure that the board and management understand investor sentiment and simmering levels of discontent are addressed before becoming an issue;
- use the results reporting periods and AGM to proactively address any perceived issues in relation to financial performance, corporate governance and executive remuneration;
- develop and implement an activist response manual.

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