Activists attack chemicals

A record number of chemical companies have been targeted by activist shareholders and more will come. What actions can and should managements take?

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For as long as there have been public markets for equities, shareholder activists have taken ownership positions in public companies and then taken action against the targeted companies for a variety of reasons. In most cases it has been to pressure management to take certain actions such as changes in strategies, cost reduction measures, divestitures of non-core businesses, spin-offs, increases in dividends, repurchases of shares, changes in leadership, replacement of board members or the sale of the entire company.

This is distinct from strategic or financial buyers who may initially acquire shares of a target in order to try to acquire the entire targeted company. A large number of chemical companies have been targeted over the last three years – more than any other industry over this time period and more are coming.

Examples in the US include American Pacific (Cornwall Capital), Ashland Chemical (Jana Partners), Ferro (FrontFour Capital Group and Quinpario Partners), Air Products (Pershing Square), Calgon Carbon (Starboard), DuPont (Trian), Dow Chemical (Third Point), LSB Industries (Engine Capital), and OMNOVA Solutions (Barington Capital).

Although the targets have been almost entirely US companies, there have been at least two exceptions – Canada's Agrium (Jana Partners – 2013, ValueAct – 2014), and Netherlands-based DSM (Third Point).

In this article, we will address a number of questions:

- Why is this happening, particularly to chemical companies?
- How has shareholder activism evolved?
- Are there different types of shareholder activists and how do they operate?
- How should the targeted company boards of directors and senior management react to these activists and why?

Daniel Loeb of Third Point (left), Nelson Peltz of Trian (centre) and William Ackman of Pershing Square are among the major activists targeting chemical companies

A SHORT HISTORY

Shareholder activists first cropped up in the 1930s, mainly where shareholders would threaten to sell their shares as a form of protest, usually with little or no effect on the company.

In the late 1940s, certain organisations focused on a particular cause would buy some shares and use their position as a shareholder to voice their concerns about certain company policies such as pension benefits.

It was not until the Securities and Exchange Commission (SEC) adopted a rule that allows shareholders of a public company to submit proposals that are required to appear in a company's proxy statement that shareholder activism became more pronounced. This rule was embodied in Rule 14a-8 of the Securities Exchange Act of 1934 and further defined in subsequent court rulings.

There is a tendency for companies to overreact. Targeted companies tend to feel threatened and ascribe more clout to the activist shareholders than they actually have

In addition, as institutional shareholders have become the dominant shareholders of US public companies, they have taken on more importance and are taking a greater activist role.

Separately, activist funds became prevalent. These funds make concentrated investments in a small number of targeted companies and act to effect changes that create "shareholder value".

Shareholder activism has been the rage since 2008 and funds are being raised in large amounts, in part due to the returns that are being achieved.

It is important to make the distinction between institutional shareholder activists and activist funds. In addition, for a certain period of time there was a subset of activists – the "corporate raider".

A "corporate raider" was the label for a certain style and form of shareholder activism that was prevalent in the 1980s.

Corporate raiders were financial investors who bought large stakes in a corporation and then attempted to either take over control or force the target to undertake measures designed to increase the share value, usually in opposition to the desires of management. The takeovers were often financed with "highly confident" high yield debt.

In most cases, the corporate raider did not succeed in taking over the company. However, often the corporate raiders were able to gain board seats, force changes in company behaviour or were paid off with "greenmail" to go away.

With the invention of the modern "poison pill" defence (a measure that prevents takeover bidders from negotiating a price directly with shareholders, instead forcing bidders to negotiate with the board) that most companies adopted, it became more difficult for a corporate raider to take over a company.

Subsequently, corporate raiders have given way to "shareholder activists", entities that take ownership positions in public companies and push for action, but not necessarily for the purpose of taking over the companies.

CHEMICAL COMPANY TARGETS

Activist/hedge funds have been most active in the US and Canada due to the more open corporate governance structure and nature of the regulatory environment.

Traditionally the chemical industry was not a target of shareholder activists because of the nature of its products, the environmental regulatory considerations, the cyclicality of commodity chemicals and the integration of many business units – making it difficult to sell or spin-off individual businesses.

However, the long periods of undervalued chemical share prices and the industry's strong cash flows ultimately attracted shareholder activists in the 1980s and 1990s such as Harold Simmons, who targeted Georgia Gulf, and Sam Heyman, who targeted GAF, Union Carbide, Hercules and Dexter. Their track records are a mixture of successes and failures.

Since then, there has been an increasing comfort level by shareholder activists in the chemical industry and the tools available in chemicals to enhance shareholder value.

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But the motives and the perceived opportunities in these situations vary greatly. The following are brief descriptions of eight of the 11 attacks by shareholder activists against chemical companies in the last three years.

Air Products: Pershing Square initiated around a 10% stake in July 2013, and called for new management and restructuring. The company added three independent directors, the CEO retired and Seifi Ghasemi became CEO.

American Pacific: Cornwall Capital Management started its campaign in 2012 and proposed changes in strategy, operations, governance, management, capitalisation and strategic plans. Cornwall was given two board seats and ultimately the company was sold to HIG in February 2014.

Ashland: Jana took a large stake in Ashland in April 2013, calling for it to streamline into just specialised higher margin chemicals. Under pressure, Ashland sold its water technologies and elastomer units, and entered into a $750m share repurchase programme.

Calgon Carbon: Starboard took a position in Calgon Carbon in November 2012 and highlighted opportunities to improve operating margins, capital allocation and corporate structure. Calgon Carbon and Starboard agreed to two new independent board members in May 2013 and to raise the threshold of the poison pill to 15% ownership from 10%. Calgon Carbon implemented many of the suggestions of Starboard, including a share buyback.

Dow Chemical: Third Point started its campaign in January 2014 urging Dow to split its commodity and specialty businesses. Dow disagreed and commenced a sale of selected commodity, non-core and impaired businesses. In December 2014, Third Point and Dow agreed to add four new independent directors, shrink the board and enter into a one-year standstill.

DuPont: Trian acquired a stake and indicated that DuPont should eliminate its holding company structure and split into two companies, "GrowthCo" (ag, nutrition and health, industrial biosciences) and "CyclicalCo/CashCo." (performance materials, safety and protection, electronics and communications). DuPont has defended its performance and is moving ahead with a spin-off of its performance chemicals business.

OMNOVA Solutions: Barington Capital issued an open letter to the company pushing for the sale of the engineered surfaces business and also launched a proxy fight to place three independent directors on the board.

DSM: Third Point has asked DSM to focus on nutritional additives and to dispose of its polymers and chemical businesses. DSM is selling some commodity chemical businesses, but has resisted Third Point overall.

These examples serve to illustrate the breadth of approaches that activist/hedge funds have taken and the differences in how companies have handled the situations.

It is our belief that less than half of the shareholder activists have been or will be successful.

The activist campaigns that have been the most successful are those where the shareholder has sufficient clout and there are legitimate actions the shareholder activist is promoting that would significantly improve the company operationally, strategically or with regard to its equity value in the public or mergers and acquisitions markets.

The ones that have failed have been situations where the activist did not have sufficient clout/leverage to cause the company to consider constructive changes or where the basic value creation premise of the activist was false.

How should senior management and the board react when they believe or know that a shareholder activist has taken a stake? First, there is a tendency for companies to overreact. Targeted companies tend to feel threatened and ascribe more clout to the activist shareholders than they actually have. After all, it is very difficult to put directors on the board of a public company, and only the board can change the CEO.

Second, companies should, as a standard practice, put in place legitimate devices such as poison pills before any actual activist actions, or even before attempts are made to acquire the company by any party, for that matter.

Undervalued chemical share prices and the industry's strong cash flows ultimately attracted shareholder activists in the 1980s and 1990s

Third, any shareholder should be treated respectfully and thoughtfully as an owner of the company. However, great care should be taken not to give one shareholder more rights or value than what is available to the broader set of shareholders. It is the duty of the board to protect the interests of all shareholders. The board also must recognise that they have a duty to other company stakeholders as well.

Fourth, targeted companies should consider suggestions that the activist shareholder may make. But in the end, senior management and the board should not take actions that are perceived to entrench existing management, cater to short-term benefits that could accrue to shareholders or to the specific activist shareholder, and be willing at times to just say "no" if what is being proposed does not make sense.

Fifth, hire an investment banking firm with chemical industry expertise to review your company's situation with regard to shareholder value and company structure, determine whether you are vulnerable to a potential attack by a shareholder activist on either a legitimate or illegitimate basis, and make changes that make sense proactively instead of defensively.

Such a review, at a minimum, will help you identify where you are vulnerable and to take protective actions, make changes where legitimate arguments exist, establish lines of communication across all stakeholders and the media, and be prepared to react in a more thoughtful and timely manner. ■

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