



# The Activism Vulnerability Report

Q3 2019

## Introduction

FTI Consulting (“FTI”) welcomes our clients and friends to our inaugural edition of The Activism Vulnerability Report (the “Report”). With the rise of shareholder activism in recent years and its evolution into an asset class of its own, FTI’s Activism and M&A Solutions team sought to assess the vulnerability of our clients and the industries in which they compete.

To accomplish this, FTI built the Activism Screener (the “Screener”), a proprietary model that evaluates U.S. and Canadian public companies’ vulnerability to shareholder activist pressures, based on a variety of quarterly reported metrics. The Screener was built and refined in 2017 and 2018 in collaboration with experts across FTI’s practices, drawing expertise from corporate finance, corporate governance, and forensic and technical accounting professionals.

Each calendar quarter, the Screener assesses the vulnerability of approximately 3,400 companies with market capitalizations of at least \$100 million using publicly available information from quarterly and annual filings. Vulnerability is represented using a composite “Total Vulnerability Score” ranging from 0.0-100.0, which is the aggregate of four underlying assessment categories; (1) Governance; (2) Total Shareholder Returns; (3) Balance Sheet; and (4) Operating Performance, which are each individually scored 0.0-25.0. The higher the Company’s Vulnerability Score, the greater its susceptibility to shareholder activism.





In this Report, FTI has and will continue to identify the industries that are most susceptible to shareholder activism in the U.S. and Canada according to the Screener’s results. The Report, and the Screener itself, are intended to assist our public company clients and their outside advisors in determining the extent to which their business and its underlying industry is vulnerable to pressure from

activist investors. It will provide a starting point for identifying and addressing the factors and dynamics that could invite activist investors to seek material changes in the underlying business, management team and/or board of directors.

The Report summarizes the Screener’s results and evaluates 25 well-known industries and enables us to understand which of those industries are most vulnerable to shareholder activism each quarter based upon an average of the aggregate vulnerability scores of the components of each industry. FTI plans to publish the Report quarterly as financial data and other common publicly disclosed information become available. While FTI will not release a complete list of companies and their scores, FTI welcomes company representatives to contact our Activist and M&A Solutions team to discuss their individual vulnerability score, and the key contributing factors.

### How is the Screener Scored?

- The Screener is a model that aggregates and analyzes over 25 criteria that are relevant to activist investors. They are sorted into four broader categories, which are aggregated to a final Total Vulnerability Score. The Screener determines a score for each category by applying weightings to each criterion based on its significance.
- By classifying the relevant attributes and metrics into broader categories, FTI is able to uncover precisely where potential vulnerabilities are found, which allows for a more targeted response.
- FTI’s Activism and M&A Solutions team determined these attributes and metrics, along with their respective weightings, through careful research of historical activist campaigns in order to locate themes and characteristics frequently targeted by activist investors. The following is a selection of themes that are included for each category:

|   |  |   |  |
|---|--|---|--|
| <br><b>Governance</b> <ul style="list-style-type: none"><li>• Proxy voting standard</li><li>• Board composition</li><li>• Proxy access</li></ul> | <br><b>Total Shareholder Return</b> <ul style="list-style-type: none"><li>• Capital gains</li><li>• Dividend and share repurchase policy</li><li>• Relative valuation</li></ul> | <br><b>Balance Sheet</b> <ul style="list-style-type: none"><li>• Capital allocation</li><li>• Leverage ratios</li><li>• Liquidity</li></ul> | <br><b>Operating Performance</b> <ul style="list-style-type: none"><li>• Revenue and earnings growth</li><li>• Profitability margins</li><li>• Merger integration</li></ul> |
|---|--|---|--|

- As specialists in the field, the Activism and M&A Solutions team is constantly following the latest trends and developments in shareholder activism. Because of the constantly evolving activism landscape, and with a desire to keep the Screener in-line with these changing market dynamics, the attributes and metrics and/or their respective weightings may be updated in future quarters.

## Most Vulnerable Industries for Q3 2019

The chart below displays the Total Vulnerability Scores for 25 well-known industries as of September 30, 2019:

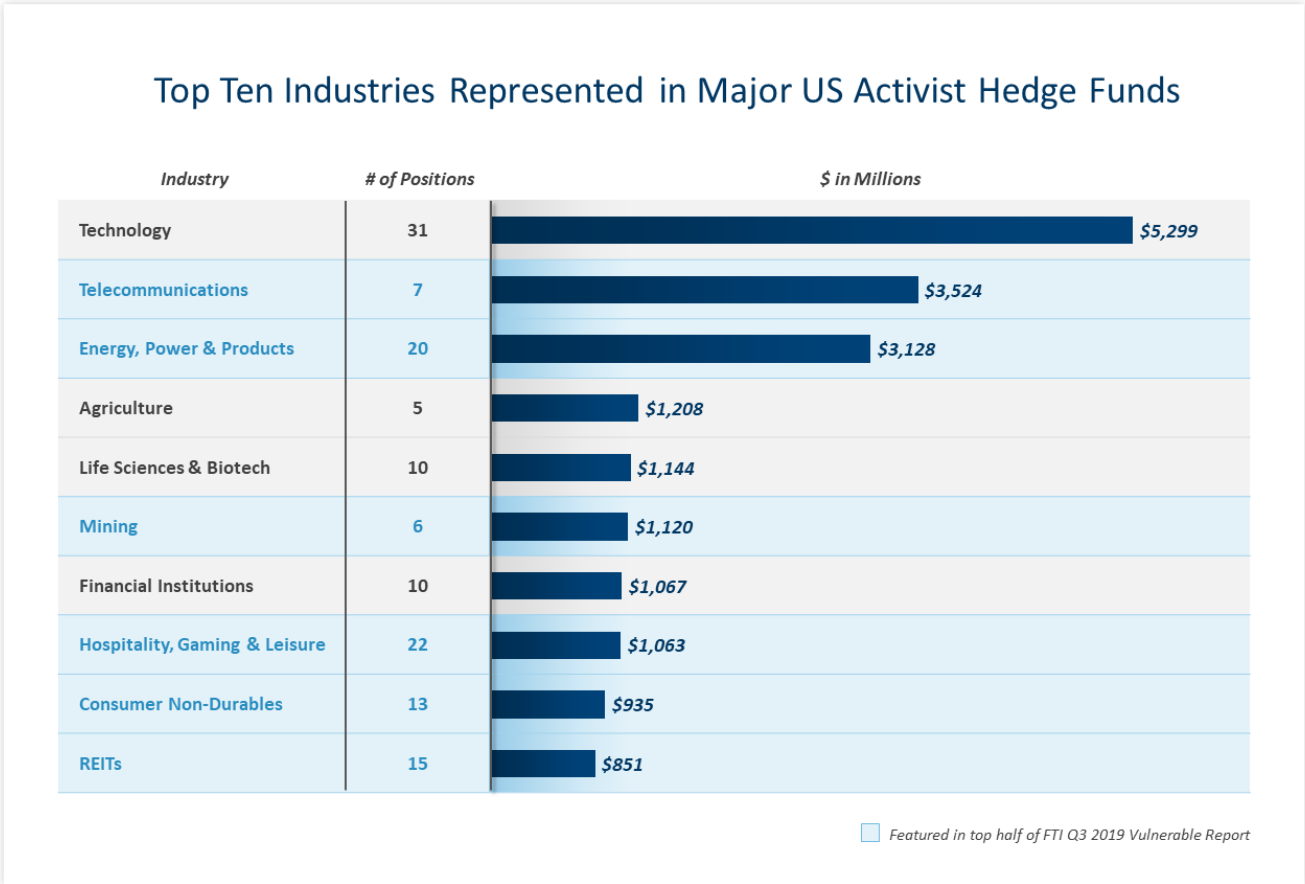
| Rank | Δ Rank QoQ | Vulnerability Score | Industry                               |
|------|------------|---------------------|--|
| 1    | No Change  | 64.9                | Publishing                             |
| 2    | ↑ 2        | 56.2                | Media                                  |
| 3    | ↓ 1        | 55.1                | Telecommunications                     |
| 4    | ↓ 1        | 51.5                | Aerospace and Defense                  |
| 5    | ↑ 5        | 49.4                | REITs                                  |
| 6    | ↑ 5        | 49.1                | Consumer Non-Durables                  |
| 7    | ↓ 1        | 49.0                | Construction                           |
| 8    | ↑ 1        | 48.9                | Hospitality, Gaming & Leisure          |
| 9    | ↑ 6        | 48.8                | Business Services                      |
| 10   | ↓ 3        | 48.7                | Mining                                 |
| 11   | ↑ 1        | 48.6                | Energy, Power & Products               |
| 12   | ↓ 4        | 48.2                | Automotive                             |
| 13   | No Change  | 47.9                | Consumer Durables                      |
| 14   | ↓ 9        | 47.9                | Agriculture                            |
| 15   | ↑ 6        | 47.6                | Pharmaceuticals                        |
| 16   | ↑ 6        | 47.1                | Real Estate                            |
| 17   | ↓ 3        | 46.6                | Professional Services                  |
| 18   | ↓ 2        | 45.2                | Large Financial Institutions & Fintech |
| 19   | ↓ 1        | 44.9                | Life Sciences & Biotechnology          |
| 20   | ↓ 3        | 44.8                | Technology                             |
| 21   | ↓ 2        | 43.8                | Healthcare Services                    |
| 22   | ↑ 1        | 43.5                | Regional Banks                         |
| 23   | ↓ 3        | 43.3                | Transportation                         |
| 24   | No Change  | 39.1                | Insurance                              |
| 25   | No Change  | 37.4                | Investment Advisory Services           |

While this is our inaugural Vulnerability Report, we have considered a number of prior quarters of Screener data from which QoQ trends in rankings were developed. While there can be much movement found from the fifth, sixth and ninth ranked industries, REITs, Consumer Non-Durables and Business Services, respectively, the top four most vulnerable industries have remained largely the same when compared to Q2 2019, with small changes in their order.

Perhaps more notably, the top three most vulnerable industries all fall within the Technology, Media & Telecommunications sector, with Vulnerability Scores of at least 55, four points higher than the next closest ranked industry.

### Major Funds' Top Holdings by Industry

FTI has identified seven primary focus activist funds and analyzed their holdings according to their Q3 2019 Form 13-Fs to provide an alternative method of identifying vulnerable industries. The graph below depicts the top ten well-known industries held by these funds and the total number of positions in their portfolios as of September 30, 2019.



Source: Activist Insight, Hedge Fund Form 13-F Filings; Note: 13-F filings include only U.S. holdings; Telecom industry data adjusted for a publicly disclosed campaign involving a large cap that was not included in certain 13-F filings.

Of the top ten industries making up the holdings seen in several major U.S. activist funds, six are within the top half of FTI’s most vulnerable industries list.

# FTI Observations and Insights

## Activism Trends

*“While there seems to be some persistent vulnerability in the Telecom, Media and Technology sector, it is interesting to see REITs, Business Services and Consumer Non-Durables, or more generally Retail, move up the list considerably. Retail should be entering its strongest seasonal period in Q4, so we will be monitoring with interest how earnings through the holiday season affect share performance and valuations.*

*REITs and Business Services may very well be moving to higher vulnerability scores in tandem, which could be correlated given the nature of those industries. We will keep a watchful eye on whether we see increased shareholder activism activity in these industries as we move towards next year’s proxy season.*

*In 2020, we anticipate seeing a continued M&A theme in shareholder activism campaigns. Developments to this theme in 2019, which we find likely to continue, were traditionally passive managers becoming vocal about understanding the strategic rationale behind mergers and being more open to siding with activists in their campaigns for higher prices in sale processes.*

*Likewise, given the sustained high valuation and low interest rate environment, we would expect to see continued activist pressure around strategic reviews and asset sales. It feels as though a number of campaigns are focused on capturing the control premium associated with M&A, as heightened valuations have made it more difficult to find significantly undervalued equities, particularly in the U.S.”*

*[Jason Frankl, Co-Head of FTI Consulting’s Activism and M&A Solutions Group](#)*

## Publishing + Digital Media

*“Newspapers are nearing a crossroads as print-based legacy revenues continue to decline and digital advertising is seeing low single-digit growth to declines. Can newspapers pivot quick enough and accelerate digital subscriptions while maintaining digital advertising and what’s left of print? Recent and projected consolidations will extend the runway for perhaps a year or 18 months, but fundamentally do not create a sustainable business model. That is the core challenge in the industry.*

*Magazines face similar headwinds with different dynamics. Driving consumer revenue is more difficult due to the years of underpricing subscriptions to maintain volume for print advertising. This has created a very low base which to increase for print and to start from for digital subscriptions. While digital subscriptions and memberships will be an important revenue stream, licensing, experiential and in some cases commerce will be critical.” [Ken Harding, Head of FTI Consulting’s Publishing + Digital Media Industry Group](#)*

## Telecommunications

*“Telecommunications companies are faced with convergence of voice, data and video, regardless of device and location. How companies manage their legacy copper plant along with their fiber, wireless and cable networks throughout this period of change will be critical to their success.*

*Meanwhile, once loyal multi-play customers are churning at higher rates as alternative solutions become available resulting in even tighter margins, high customer acquisition costs and longer payback. The wireless companies are facing a different challenge as they race to deploy 5G. Are wireless companies deploying too much capital too fast in the race to deploy 5G? Will “first to market” determine the financial winners and losers?” [Melker Sandberg, Senior Managing Director in FTI Consulting’s Telecom Industry Group](#)*

## What This Means

Shareholder activism as an asset class is here to stay. It continues to progress to include a broader group of active money managers looking to engage meaningfully with their portfolio companies, whether that is welcome or not. Index funds and other traditionally passive managers have shown an increased sophistication in their corporate voting standards, and in some cases in their relationships with active money managers. Such passive, or permanent investors, are becoming more willing to side with activists, which has in turn given activists more voting power for their investments and leverage in their negotiations with management teams and boards of directors.

While some industries are more susceptible than others, every company needs to be acutely cognizant of its key vulnerabilities and how it stands compared to industry peers. By recognizing weaknesses and addressing a strategy to investors to improve them prior to an activist’s presence, management and boards can further build credibility with shareholders, eliminating a major advantage typically held by activists.

FTI Consulting’s Screener provides a starting point for companies and their advisors seeking to locate their most prevalent vulnerabilities from an external perspective. Once this is complete, a more in-depth analysis of specific factors across each Screener category is necessary to craft a long-term, actionable plan to address these vulnerabilities and to increase the confidence of all investors, including those not yet present.

## FTI Overview



### Transactions

- Due Diligence
  - Financial
  - Commercial
  - Operations
  - Investigative & Forensic Accounting
  - IT
- Valuation & Fairness Opinion
- Integration/Synergy Planning & Execution
- Merger Integration & Carve-Outs
- Activist Investing/Activist Defense
- Intangible Asset Valuation
- Post-acquisition Resolution
- IPO Readiness
- Anti-Trust Consulting
- Special Situations Investment Banking



### Growth & Transformation

- Strategy Development & Implementation
- Performance Improvement
  - Operational Excellence
  - Customer Profitability
  - Data Analytics
  - Sales Force Effectiveness
- Strategic IT
- Interim Management
- Strategic Communications
- Real Estate Optimization
- Low Cost Country Sourcing



### Times of Distress

- Restructuring
  - Debtor/Company
  - Lenders/Noteholders
  - UCC
  - Court Appointments
- Valuation & Solvency Opinions
- Special Situations Investment Banking
- Dispute Advisory/Contentious Insolvency
- Crisis Communications/Internal & External Communications
- Real Estate Optimization

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