The Activism Vulnerability Report

AN FTI CONSULTING REPORT –
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Introduction

A resilient U.S. economy, with inflation cooling from 2023 levels and interest rates likely peaking, can provide a favorable backdrop for shareholder activism and M&A in 2024. Activist activity was strong in 2023 and there are clear signs that momentum has carried into 2024. We could see activism and M&A activity ramping up over the coming months, as companies seek growth opportunities, and based on the results of our proprietary screener, the most vulnerable industries are Utilities, Airlines & Aviation and Media & Publishing.

In this issue of the FTI Consulting Activism Vulnerability Report, we offer more insights, analysis and commentary, including sections on high profile activist campaigns involving Disney and Starbucks. As with prior reports, we provide key trends in activism campaigns.

Recent Activist News Highlights

February 2024

— Elliott Management ("Elliott") gained two board seats in its campaign against Phillips 66. Elliott aims to strengthen Phillips' board with two new directors to help management achieve its targets. Elliott also suggested broader changes to leadership, operations and capital allocation.

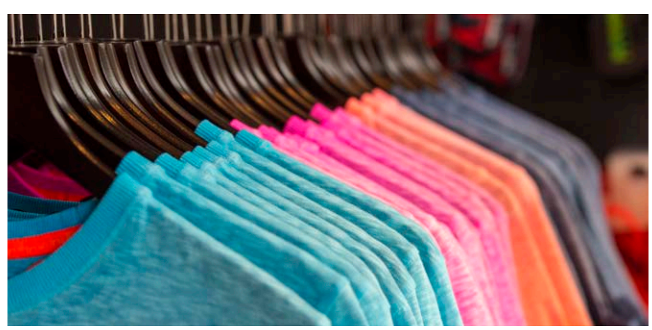
— Carl Icahn swiftly clinched two wins, gaining two board seats at both American Electric Power Company and JetBlue Airways in campaigns lasting just one and four days, respectively.

March 2024

— The Strategic Organizing Center ("SOC") withdrew its campaign against Starbucks, where it had nominated three directors and cited "severe human capital mismanagement." Starbucks added three new directors in January and claimed support from both Glass Lewis and Institutional Shareholder Services ("ISS"). The SOC ended its campaign on March 5, citing progress in collective bargaining negotiations. On March 13, shareholders elected all 11 company nominees and voted against three shareholder proposals. See page 8 for more insight.

Ongoing

- The Walt Disney Company's ("Disney") Board is attempting to fend off multiple activists after Trian Partners ("Trian") and Blackwells Capital ("Blackwells") each put forward multiple nominees in separate contests. See page 9 for more insight.
- Activists piled into Gildan Activewear ("Gildan") following the initiation of Browning West's campaign at the company, prompted by the departure of President and CEO Glenn Chamandy in December 2023. Coliseum Capital Management ("Coliseum") quickly settled for a board seat. On March 19, 2024, Gildan received a confidential bid of $42 per share. Browning West argues that the price reflects no premium to the value it plans to bring to the stock. Activists are continuing to pressure the company, with Browning West aiming to install eight directors at the May 28, 2024, annual meeting.
- Engaged Capital approached VF Corp ("VF") in October 2023, claiming that VF's share price could triple. After refreshing its board with one Engaged Capital nominee on February 14, 2024, and plans to appoint another, VF stated that it looks forward to continuing the "constructive" engagement. Activist Legion Partners continues to circle the company following Engaged Capital's success.
- Ancora Advisors ("Ancora") is leading an investor group in a push to replace the majority of directors and the CEO at Norfolk Southern Corporation.
- Macy's received a buyout offer from activists Arkhouse Management ("Arkhouse") and Brigade Capital Management ("Brigade") in November 2023. Macy's initially rejected the bid in January 2024, after announcing plans that include cutting 2,350 jobs and closing five stores. Arkhouse put forward a slate of nine nominees in response to the Board's alleged use of "delay tactics." Arkhouse and Brigade have since increased their cash offer from $21 per share to $24 per share. Macy's and its potential buyers began negotiations for a deal, granting buyers access to Macy's books, though Arkhouse has no plans to stop its proxy contest.

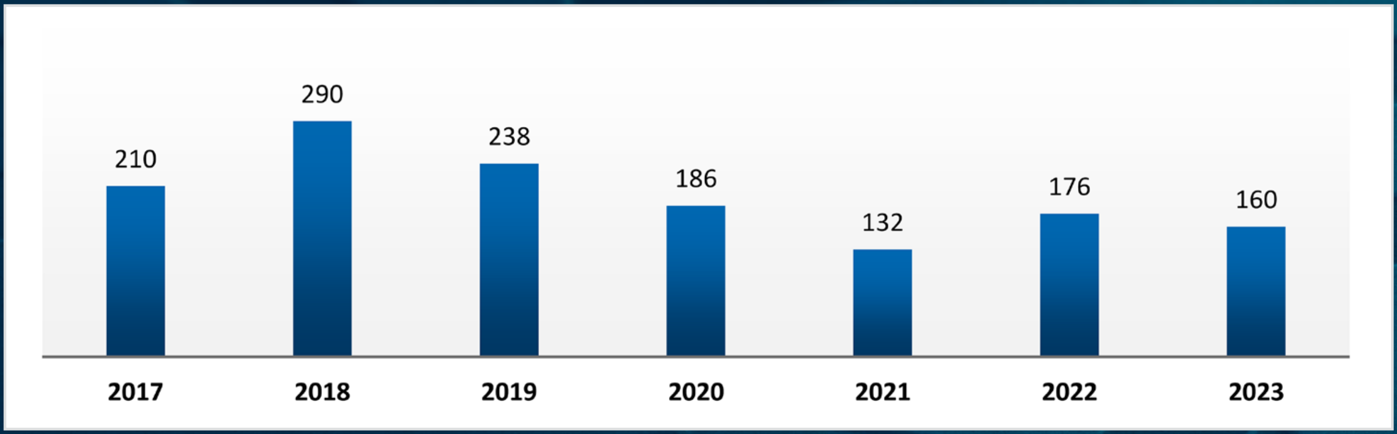


Activism Activity in 2023

Last year was a lively one for activists with 396 new campaigns, a 13% increase over the prior year, representing the second-highest campaign total in the past five years. Much of the increased activity took place in the final quarter of the year, when 103 new campaigns were launched, a 39% year-over-year increase.

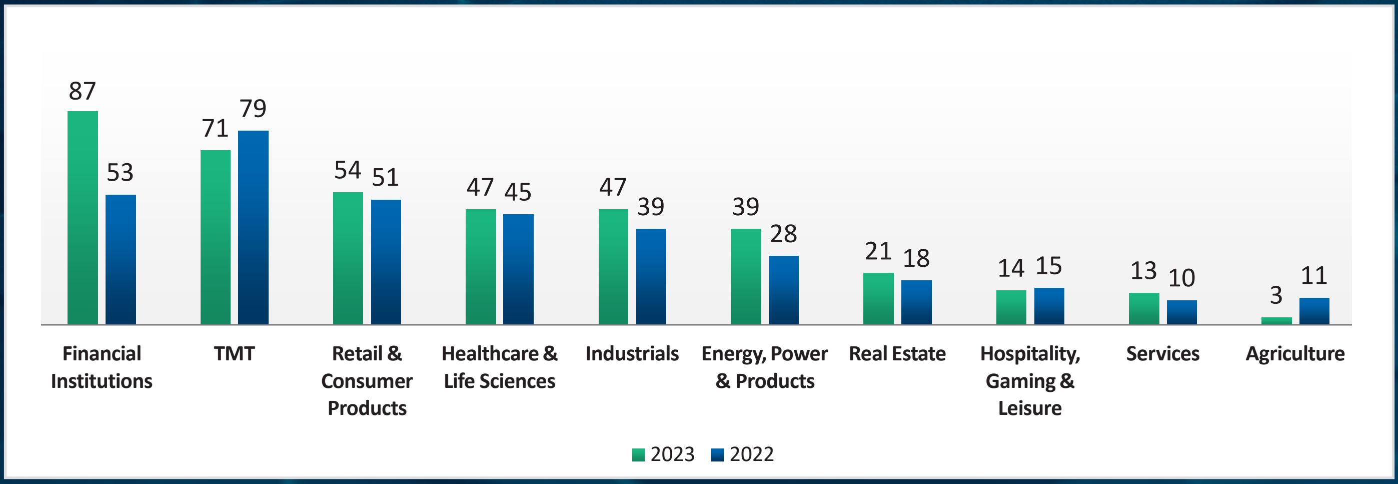
This year is proving to be another active one. Through the first 12 weeks, there have been 111 campaigns launched, well above the average of 98 over the past five years.[1]

Total Board Seats Gained in the U.S.



Contrasting the strong start to 2024 in terms of new campaign initiations, thus far in 2024, activists have won 33 board seats, a decline of 35% relative to the same period last year. Such results seem to be a continuation of the annual decline in board seats attained in 2023.

Annual New Campaign Totals by Sector



Most Active Sectors…

Financial Institutions, Technology, Media & Telecommunications (“TMT”) and Retail & Consumer Products experienced heightened activist activity in 2023.

The Financial Institutions sector was targeted a total of 87 times in 2023, a 64% increase from 2022, with most of the activity occurring in the first half of last year, during the regional banking crisis.[2]

— Notable activity in 4Q23 included Stilwell Value’s (“Stilwell”) appointment of Dennis Pollack to the boards of Provident Bancorp and its subsidiary, and Land and Buildings’ ongoing campaign seeking board representation at REIT Tricon Residential.[3]

— In 1Q24, Stilwell initiated a campaign against Peoples Financial Corporation for the fourth consecutive year, after failing in its previous three efforts. Carrying momentum, the activist later won a seat at Ottawa Bancorp through settlement in late March.[4] Also, in 1Q24, Strategic Value Bank Partners won a seat at BankFinancial Corporation through a settlement.[5]

— Underlying these campaigns are beliefs that the sector has yet to fully recover from the regional banking crisis in the first half of 2023. With the value of many commercial real estate properties having fallen sharply over the last five years, investors are concerned about the loans made to those properties’ owners and their lack of ability to refinance the debt; such loans appear to be concentrated among small and mid-sized banks.[6] For example, in early March 2024, Liberty Strategic Capital and other investors invested a combined total of nearly $1 billion in capital into New York Community Bank, effectively taking control of the troubled bank plagued by material weaknesses in evaluating its portfolio of loans.[7,8]

Activity within TMT declined 10% year-over-year, but remained high, as a total of 71 campaigns were initiated throughout 2023 (21 in 4Q23).[9]

— To name a few in 4Q23, Trian began pushing for change at Disney, Voss Capital gained an additional board seat at Thunderbird Entertainment Group and D.E. Shaw Investment Management won three seats on L3Harris Technologies’ board.

— In 1Q24, Blackwells began seeking three seats at Disney, while Starboard Value and Rubric Capital Management initiated campaigns at Alight and Xperi, respectively.

— Interestingly, 11 campaigns within the TMT sector in 2023 focused on pushing for M&A. Despite rapidly rising interest rates and multi-year lows in M&A activity, activists seemed to have identified value within the markets in 2023. As rates come down and the M&A market begins to recover, we expect campaigns to ramp up.[10]

Activity in the Retail & Consumer Products sector surged 186% in the final quarter of 2023 relative to 2022, partly due to wolfpacking.

— In December, 10 activists piled into Gildan, though only two sought board representation: Coliseum and Browning West (Coliseum swiftly won a seat but Browning West is still fighting).[11]

— An additional example within the sector during 2023 was Stadium Capital Management and Blue Clay Capital Management’s campaign at Sleep Number Corp., which resulted in the appointment of two new directors.[12, 13]

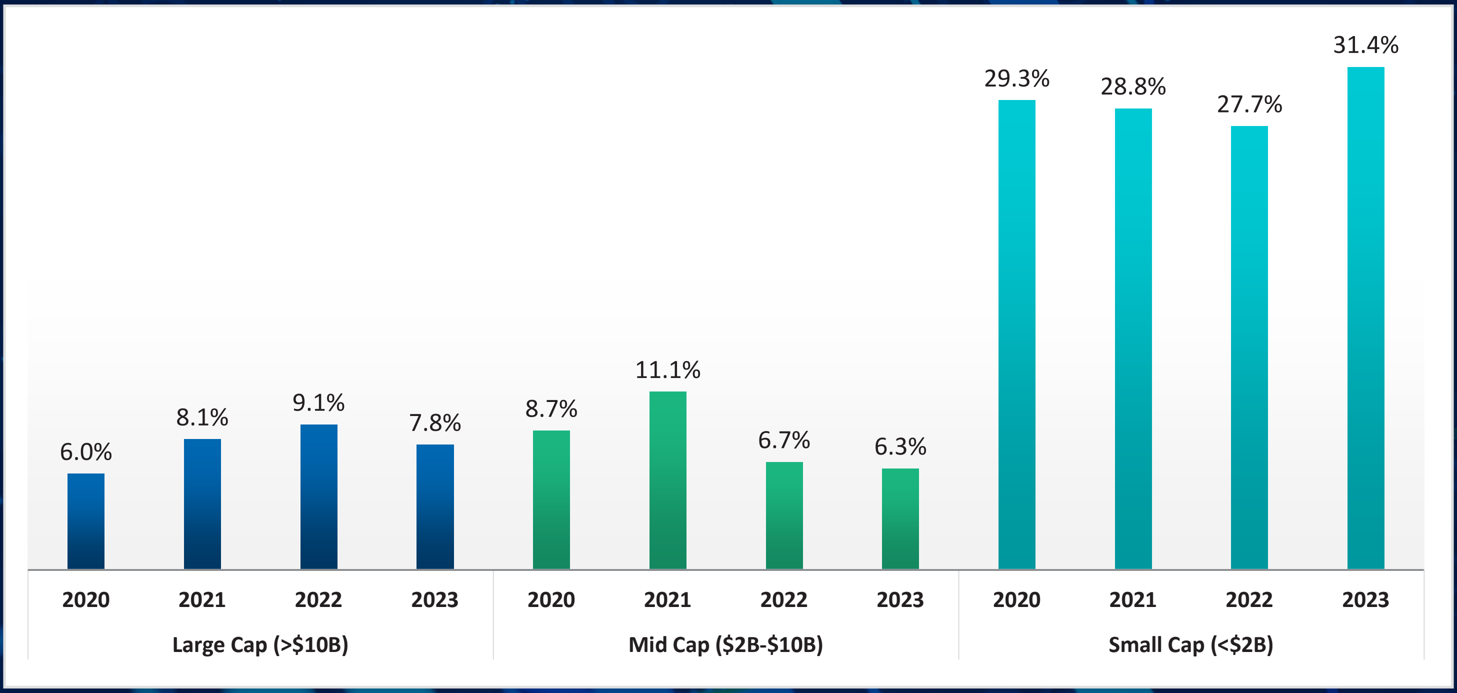
— We have seen activists leverage wolfpacking in early 2024 as Legion Partners, Third Point and Saddle Point Management circled Advance Auto Parts, with the latter two winning three seats on the board.[14]

— Overall, wolfpacking, when used intentionally, seems to be a winning strategy for creating change as additional activist voices pushing against a single company can create a sense of unanimity within the market.

Greater Success in the Small-Cap Space

Activists are finding increasing success targeting small-cap firms. In 2023, activists' objectives were partially or fully successful 31% of the time when targeting smaller-cap firms, representing the highest success rate in the post-pandemic era. In comparison, activists found success only 8% and 6% of the time when targeting large- and mid-cap firms, respectively. The number of campaigns in the small-cap space also reached a multi-year high of 214, suggesting that activists understand the upside here as well.[15] The success within this segment of the market may occur for several reasons. Small firms tend to have less manpower and financial resources than larger companies, which may make them more likely to settle than larger companies. The UPC potentially opens the door for a greater number of campaigns targeting smaller companies.

Activist's Objectives Partially or Fully Successful



Screener Results and Insights: 4Q23

In the following section, we have deployed FTI Consulting's proprietary vulnerability screener to help our clients understand the risks and areas of focus. While our model is based on bottom-up analysis, we provide broader results by industry to illustrate trends.

- The top three **most vulnerable** industries are Utilities, Aviation & Airlines and Media & Publishing due to underperforming total shareholder returns ("TSR"), elevated debt levels resulting from capital-intensive operations, and reduced revenue growth.
- Based on our analysis, Investment Managers, Construction and Energy ranked as the **least vulnerable**.
- We observed the greatest vulnerability increases in interest rate-sensitive sectors, such as Savings Banks, Regional Banks and REITs. The Real Estate and Financial Institutions sectors saw the largest rise in vulnerability driven by poor TSR and weaker balance sheets.
- Meanwhile, the Life Sciences, Restaurants and Insurance industries experienced the most significant improvement. The Healthcare & Life Sciences sector experienced the largest decrease in vulnerability scores, with improved TSR which appears to reflect some degree of sector rotation.

Rank	Change in Rank QoQ	FTI Consulting Industry	FTI Consulting Sector	4Q23 Vulnerability Score	3Q23 Vulnerability Score
1	▲ 2	Utilities	Energy, Power & Products	62.8	59.6
2	-	Aviation & Airlines	Industrials	62.4	61.1
3	▲ 1	Media & Publishing	TMT	59.2	57.6
4	▲ 1	Telecommunications	TMT	58.9	56.9
5	▼ 4	Biotechnology	Healthcare & Life Sciences	58.8	61.7
6	▲ 3	Real Estate	Real Estate	56.1	54.8
7	▲ 9	REITs	Real Estate	54.1	52.5
8	▲ 14	Savings Banks	Financial Institutions	53.8	50.3
9	▼ 3	Pharmaceuticals	Healthcare & Life Sciences	53.6	56.7
10	▼ 3	Healthcare Services	Healthcare & Life Sciences	53.5	56.4
11	▲ 1	Automotive	Industrials	53.4	53.2
12	▼ 1	Chemicals	Agriculture	53.0	53.3
13	▼ 3	Consumer Durables	Retail & Consumer Products	53.0	53.5
14	▲ 3	Consumer Non-Durables	Retail & Consumer Products	51.7	52.4
15	▼ 2	Agriculture & Chemical Products	Agriculture	51.6	53.1
16	▼ 2	Business Services	Services	51.4	52.9
17	▼ 9	Life Sciences	Healthcare & Life Sciences	51.4	55.5
18	▲ 2	Hospitality & Gaming	Hospitality, Gaming & Leisure	50.9	51.8
19	▲ 2	Consumer Finance	Financial Institutions	50.5	50.6
20	▲ 3	Professional Services	Services	50.3	49.7
21	▼ 3	Technology-Software	TMT	49.3	52.0
22	▼ 7	Restaurants	Hospitality, Gaming & Leisure	49.2	52.5
23	▼ 4	Financial Conglomerates	Financial Institutions	49.1	51.9
24	▲ 10	Regional Banks	Financial Institutions	48.3	43.6
25	▲ 2	Industrial Distributors	Industrials	47.9	48.1
26	▼ 2	Mining	Industrials	47.7	48.7
27	▲ 5	Power	Energy, Power & Products	46.6	44.8
28	▼ 2	Technology-Hardware	TMT	46.5	48.4
29	▲ 4	Banks	Financial Institutions	46.4	44.8
30	▼ 2	Industrial Equipment	Industrials	46.2	47.7
31	▼ 2	Aerospace and Defense	Industrials	46.1	46.9
32	▼ 7	Insurance	Financial Institutions	45.9	48.4
33	▼ 3	Transportation	Industrials	45.5	46.7
34	▲ 2	Energy	Energy, Power & Products	44.3	39.0
35	▼ 4	Construction	Industrials	43.6	45.4
36	▼ 1	Investment Managers	Financial Institutions	41.9	41.3

Blockbuster Campaigns

STARBUCKS

In March, the Strategic Organizing Center, a coalition of labor unions, withdrew the three directors it had nominated to Starbucks' board in a proxy contest.[16] The withdrawal followed an agreement between Starbucks and the labor union, Workers United, to begin discussions on a framework designed to achieve collective bargaining agreements and a resolution of litigation between the two.[17] SOC's withdrawal also followed recommendations from major proxy advisors, ISS and Glass Lewis, in favor of all company-nominated directors.[18, 19]

Two unrelated factors resulted in the SOC failing to win proxy advisors' recommendations: Starbucks' strong long-term shareholder returns and the SOC's inability to directly link its critique to Starbucks' underwhelming short-term returns.

Investors may perceive rapidly growing, technologically innovative stocks as the primary way to achieve immense long-term wealth in the stock market. However, even in competitive and seemingly mature industries, well-run firms that deliver value to customers can create substantial shareholder value. As the report by ISS highlighted, this has been the case with Starbucks.[20] Other restaurant chains, such as Domino's and McDonald's have also delivered robust TSR over many years. And over the past 20 years, as those companies thrived, many rivals in this highly competitive industry have fared far less well.

Period ended Feb. 29, 2024	One-Year TSR	Five-Year TSR	10-Year TSR	20-Year TSR
Starbucks Corporation	**-5.0%**	**49.3%**	**222.1%**	**1198.5%**
Domino's Pizza, Inc.	54.6%	88.3%	530.2%	
McDonald's Corporation	13.2%	78.4%	299.0%	1683.7%
S&P 500	30.5%	99.1%	230.5%	560.2%

Source: FactSet

The table above shows a notable divergence between Starbucks' strong, long-term relative TSR and its weak, shorter-term TSR, something that ISS noted. Nevertheless, ISS recommended shareholders vote for all the company's nominees, stating that the dissident had not established a definitive connection between the TSR divergence and the unionization matters.[21]

Like the SOC, other activists at times have failed to establish that a material link exists between the issues they are raising and a company's subpar operational performance and TSR. Voce Capital criticized CEO compensation at Argo International in its spring 2019 proxy contest.[22] In this contest as well, when ISS recommended for all Argo incumbent nominees, it stated that a definitive link had not been established.[23]

By contrast, Glass Lewis agreed with Voss Capital's criticism of Griffon Corporation's board structure and composition in 2022.[24] Voss' investor presentation tied Griffon's long-tenured board and its above-peer executive compensation to declining pretax income, and quantified how much that extra compensation reduced pretax income.[25] Glass Lewis agreed with this linkage, as it recommended for Voss' nominee.[26]

These examples highlight an activist has the responsibility to make a compelling case for change, not just establish that a company has certain shortcomings. The activist must show how those shortcomings have hurt shareholder returns and merit new directors.

DISNEY

This year's highest-profile activist campaign is nearing its conclusion, as Disney's annual meeting of shareholders will be held on April 3, 2024.[27] Round Two between Trian and Disney has been complicated by the presence of three additional activist investors: Blackwells, ValueAct Capital ("ValueAct") and Ancora. Can any activist approaches persuade shareholders to elect dissident nominees, which would be an implicit rebuke of Disney's renowned CEO, Bob Iger?

A year ago, on February 9, 2023, Trian abandoned its initial pursuit of board representation when Disney announced a series of operating initiatives. Yet in early October 2023, Trian reignited an attempt for board representation, asserting that the Board was too connected to long-tenured CEO Iger and too disconnected from the interests of shareholders. Trian later nominated Peltz and former Disney CFO, Jay Rasulo, to Disney's board, and called for enhancements to corporate governance and improved operations within streaming and parks.[28, 29]

Major proxy advisors split their recommendations in the Disney contest. Glass Lewis preferred all management nominees, while ISS recommended that shareholders vote for one Trian nominee, Peltz.[30, 31] Disney's large retail shareholder base presents an obstacle to any activist, and public endorsements of Disney's slate from Walt Disney's grandchildren and JP Morgan Chase CEO, Jamie Dimon, have helped the company.[32, 33] Even Disney shareholder George Lucas, the creator of Star Wars and Indiana Jones, chimed in for Disney, stating "Creating magic is not for amateurs."[34]

Blackwells employed an unusual approach, criticizing Trian and backing Iger publicly, while nominating three directors to the board.[35] Blackwells stated that if its nominees won, it would reappoint to the board the three displaced, incumbent directors.[36] Despite Blackwells' more conciliatory approach, Disney rejected Blackwells' nominees and views.[37] In response, Blackwells switched gears and issued a lengthy presentation that claimed persistent underperformance of Disney shares under its current Board.[38] Neither ISS nor Glass Lewis recommended for any of Blackwells' nominees.[39, 40]

Interjecting themselves into the situation were two additional, prominent activists. Ancora sought a compromise between Trian and Disney, with both sides working together to improve shareholder value.[41] In mid-November 2023, public filings revealed that ValueAct had built a stake in Disney.[42] Media reports indicated that ValueAct's chief, Mason Morfit, and Iger had close personal ties.[43]

On January 3, 2024, Disney announced a confidentiality agreement with ValueAct to facilitate value creation consultation during the Company's transformation period.[44] On March 11, 2024, however, it was revealed that ValueAct had managed over $350 million of Disney's pension fund assets and earned fees from Disney, which Blackwells characterized as a conflict of interest.[45, 46]

Disney has posted solid long-term TSR since Iger became CEO in 2005. However, it has been a tale of two decades. In Iger's first decade leading the company, Disney's TSR outperformed the S&P 500 and that of perhaps its closest peer, Comcast.[47] In the second decade since he became CEO, Disney underperformed both substantially. ISS's report notes several factors that have contributed to Disney's relatively weak, near-term TSR, including a failed CEO succession plan and its acquisition of Fox in 2019.[48]

Period Starting Sept. 30, 2005 – Bob Iger Hired as Walt Disney CEO

Company	First Decade Sept. 30, 2005 – Sept. 30, 2015	Second Decade Sept. 30, 2015 – Mar. 15, 2024	Hired as CEO – Current Sept. 30, 2005 – Mar. 15, 2024
Walt Disney Company	388.8%	17.2%	473.1%
Comcast Corporation Class A	232.3%	80.1%	498.4%
S&P 500	93.1%	211.3%	501.1%

Source: FactSet

The TSR profile of Disney, with strong long-term TSR but weak near-term TSR, resembles that of Starbucks. In each case, activists encountered a strong consumer brand and a large base of retail shareholders, who tend to have lower turnout in proxy contests and typically vote with management.

Trian faced the additional headwinds of a second activist, whose campaign muddied the situation; a celebrity CEO who is well-respected among business and industry leaders; and a target whose stock price has surged since the campaign began. Disney also has made several changes in its strategy and cost structure, both since Trian's initial campaign more than a year ago and since its most recent campaign starting in January 2024. Trian's campaigns appear to have catalyzed at least some of Disney's recent enhancements.

Looking Ahead

While 2023 was a very active year of campaigns, interestingly, there were fewer board seats acquired than in years past. We plan to monitor this trend closely as the effects of new regulation continue to ripple through the market. Looking ahead, we believe that there will likely be increased M&A activity more broadly, as companies seek opportunities to expand to new markets and bolster existing core strengths through tuck-in acquisitions. We see the greatest vulnerabilities in the small-cap arena, particularly in the Utilities, Aviation & Airlines and Media & Publishing industries and suggest operators in those industries be ready to take action.

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