

Activist investors target chemicals

These shareholders have taken stakes in a number of chemical companies such as DuPont, Air Products and Ashland. How should managements act?

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For as long as there have been public markets for equities, activist shareholders have taken ownership positions in public companies and taken action against targeted companies for a variety of reasons.

In some cases it has been to pressure management to take certain business actions such as cost reduction measures, divestitures of non-core businesses, spin-offs, dividend increases, share buybacks, changes in leadership or the sale of the entire company.

This is distinct from strategic or financial buyers who may initially acquire shares of the target in order to try to acquire the entire targeted company.

A large number of US-based chemical companies have been targeted by activist shareholders over the past year. Examples include American Pacific (Cornwall Capital), Ferro (FrontFour Capital Group and Quinpario Partners), Air Products (Bill Ackman of Pershing Square Capital), DuPont (Nelson Peltz of Trian) and Ashland (Jana Partners).

Case by case, the companies have had to deal with the activist and have reacted in a number of ways.

American Pacific has granted the activists seats on the board and is evaluating its strategic options.

Ferro agreed to accept two board members from the activist shareholder group and to form a committee to examine ways to enhance shareholder value. They have embarked on a cost cutting program, sold off small non-core

businesses and fended off an offer for the whole company from A. Schulman.

Ashland has increased its dividend and share repurchases and has begun to sell off a number of businesses (elastomers and water technologies) that the company had intended to sell eventually.

It is also our belief that only a few of the activist shareholders will be successful

DuPont has announced that it will consider a spin-off or sale of its performance chemicals division that represents \$7bn (€5bn) of its revenues.

MOTIVES

Why is this happening? Is it happening more to chemical companies than to other companies? Is there a distinct pattern with regard to what companies have been targeted and the motives of the activist shareholders?

The chemical industry is not the only industry that has been the target of shareholder activism. There has been a high level of activity across many industries in 2013. The list of examples is very long.

Shareholder activist Carl Icahn has gone after a string of companies in many industries with significant financial success. Some of the activist efforts have garnered a great deal of publicity, such as Bill Ackman of Pershing

Square's actions against P&G, Beam, Canadian Pacific, Target and J.C. Penney.

In Ackman's case, he has targeted companies that have struggled financially or those he believes have weak strategies. Although he has had successes, he also had a well publicized failure with J.C. Penney that resulted in significant financial losses after he forced a change in the CEO and the company's strategy that failed.

Now Ackman has gone after Air Products and has accumulated a 10% stake in the company. The media has suggested that the Air Products board has reacted by agreeing to add three independent directors and announcing that the CEO plans to retire as CEO in 2014.

Jana Partners has been pressuring Canada-based fertilizer firm Agrium since May and is now going after Ashland.

VALUATIONS HIGH

It is particularly interesting that the activity has been so high at a time that the valuation of shares have also been high. One would think that shareholder activism would primarily surface when shares are undervalued.

However, many of the claimed shareholder value gaps cited by activist shareholders are independent of the existing public valuation of the targeted companies.

Also, some of the drivers include record levels of cash on corporate balance sheets, a ready supply of inexpensive debt and the success that activists have had in attracting investment capital.

Industries and companies that are targeted vary considerably and the motives and objects are very diverse.

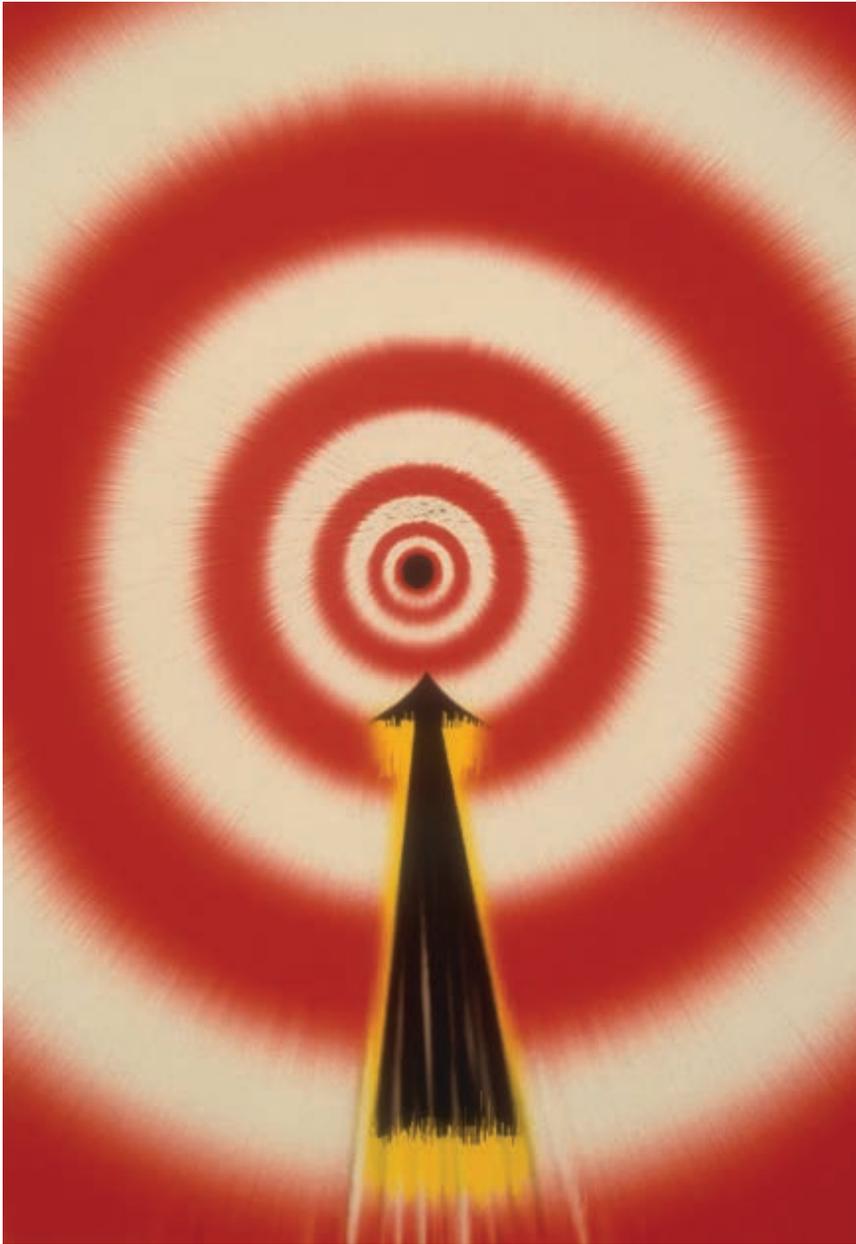
The motives can range from a desire to increase the value of the shares short-term and to cash out through a sale of the company, a desire to be bought out by the company (once called "greenmail" years ago), to a true desire to be a medium to long-term owner pushing the company to improve its earnings, strategy, business profile/portfolio, leadership, or cost structure.

A number of industries such as retail, ener-

ACTIVISTS IN CHEMICALS

Activist shareholder	Target	Stake
Trian (Nelson Peltz)	DuPont	NA
Pershing Square (Bill Ackman)	Air Products	9.8%*
Jana Partners	Ashland	7.4%**
FrontFour Capital/Quinpario Partners	Ferro	NA
Cornwall Capital	American Pacific	14.8%***

Source: US Securities & Exchange Commission, media reports. Notes: *13D filing on 31 July 2013, **13D filing on 11 April 2013, ***13D filing on 14 January 2013



Companies targeted by activist shareholders tend to overreact

gy, software, industrials and chemicals seem to be of particular interest to activists recently.

CHEMICAL CHARACTERISTICS

Traditionally the chemical industry was not a target of activist shareholders because of the nature of its products, the environmental regulatory considerations, the cyclicity of commodity chemicals, and the integration of many businesses units with each other – 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 activist shareholders in the 1980s such as Harold

Simmons, who targeted Georgia Gulf; and Sam Heyman, who targeted GAF, Union Carbide, Hercules and Dexter. Their track record was a mixture of successes and failures.

Since then, there has been an increasing comfort level by activist shareholders in the chemical industry and the tools available in chemicals to enhance shareholder value. But the motives and the perceived opportunities in the current situations vary greatly.

SUCCESS FACTORS

It is also our belief that only a few of the activist shareholders will be successful. The ones that will be successful are in situations where

the shareholder has sufficient clout and there are legitimate actions that the company can take that the activist is promoting that could significantly improve the company operationally, strategically or with regard to its equity value in the public or mergers and acquisitions (M&A) markets.

The situations ripe for failure are those where the activist shareholder does not have sufficient clout/leverage to cause the company to consider constructive changes or where the basic value creation premise of the activist shareholder is false.

COMPANY REACTIONS

How should senior management and the board of directors react when they believe or know that a shareholder activist has taken a stake in the company?

First, there is a tendency for companies to overreact. Targeted companies tend to feel threatened and ascribe more clout to the activist shareholders than the activists actually have.

After all, it is very difficult to put directors on the board of a public company because of staggered boards (where a limited number of seats come up for re-election each year), the proxy and nomination process, and the fact that board seats only change once a year generally at the annual meeting. And only the board can change the CEO of the company.

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

Third, any shareholder should be treated respectfully as an owner of the company, especially if they own a meaningful stake.

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 of the company. It is the duty of the board to protect the interests of all shareholders. The board also must recognize that they have a duty to other company stakeholders as well.

Fourth, 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 to shareholders or to the specific activist shareholder. It must be willing at times to just say “no” if what is being proposed does not make sense. ■



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