

THE KEY STEPS TO IDENTIFYING HIDDEN SHAREHOLDER RISK

HOSTED BY AIR & CMI2I



Associazione Investor Relations



What do we mean by shareholder risk?

- **External Activists**

Traditional shareholder activists who are looking to acquire shares and push for change to unlock value (Elliott Management, Icahn Associates, Pershing Square, Starboard Value, Teleios Capital and CIAM)

- **Internal Activists**

'Active' shareholders who are now holding companies to account on a broad range of issues beyond financial performance, often relating to ESG (Man Group, Royal London Asset Management)

- Both types are likely present in your shareholder base

According to CMi2i's research of European issuers, 96% had at least one fund with a history of activism holding their shares. The average number was seven, with around 10% having more than 15 activist funds holding.



Where can risk lie?

- **Financial Risk**

- The more traditional angle of attack for Activists is to unlock value through Financial Engineering

- **Non-financial Risk**

- The more recent angles of attack are to focus on poor Corporate Governance standards

And/or

- ESG risks

Vulnerability indicators to be aware of

Vulnerability is highest when a company is underperforming across a number of metrics – financial and non-financial:

- Long term TSR performance declining (1, 3, and 5 years)
- Remuneration not in-line with peers / lacks KPIs relating to ESG
- Votes against at shareholder meetings - any resolution with less than 96% in favour, indicates higher risk (especially if multiple years of problems)
- Accounting / audit strength
- Turnover of shares – excessive turnover indicates potential risk
- Lack of net zero commitment; feasible climate plan
- Lack of board diversity / independence



There has been noticeable hedge fund activity

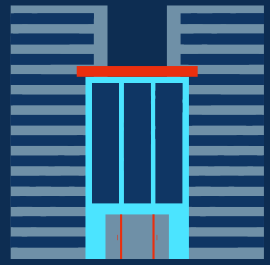
Hedge funds and Merger Arbitrage Funds, especially those that buy shares after a shareholder resolution has been proposed by an 'active' shareholder, or after a traditional activist has published their paper, are an indicator of risk.

As most hedge funds hold indirectly, to be able to really quantify a company's risk to hedge funds, it is also necessary to look at changes in Custodians prime broker levels and stock lending.



There has been an increase in prime brokers holding shares

As prime brokers primary function is to cater to hedge fund acquisitions, we look closely at their presence as an indicator of risk.

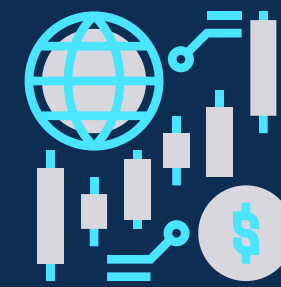


Notable passive shareholder ownership

Passive Investors tend to be more supportive of both types of activist shareholders than active investors as they do not have the option of selling out. The major index funds typically hold disproportionately large positions and are more likely to vote - and vote in favour of shareholders pushing change at AGMs/EGMs.

Indicator 4

Given that it is unlikely that long-only funds will be lending to other long-only funds, it is more likely that they will be lending to investors taking a short-term positions. This is evidenced by a significant number of institutions increasing the number of their shares out on loan.



**Increased
stock lending
over the
quarter**



Substantial ESG risk rating divergence

One way of determining the level of potential 'active' shareholders that may propose an unwanted resolution at an AGM (for example demanding a science-based net zero plan or better climate change commitments) is by looking at the portfolio average of the fund's ESG risk rating relative to that of the company. By doing this we can see which investors view the company as a 'high' ESG risk relative to their other investments.



Concentration of ownership amongst top holders

A concentration of ownership means that an investor that is pushing for change has less people to convince to take their side. Particularly for companies with limited free float, a diversified shareholder base is one of the best defences and a key element of a risk analysis.

Indicator 7

US shareholders are typically more likely to support an activist campaign. An increase in US ownership is a risk indicator that should be investigated in more depth.



Increased US Ownership



OFFICE

21-26 Garlick Hill, London EC4V 2AU

EMAIL ADDRESS

info@cmi2i.com

PHONE NUMBER

+44 (0) 203 824 1450

Thank you