

## In The Know Leveraged Finance Newsletter

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### Activism and debt considerations

#### Overview

Global activism was especially pronounced in 2024, reaching its highest level since 2018. Activists generally focused on the industrials and technology sectors, while a third of campaigns targeted mega-cap companies. More than a quarter of global activist campaigns launched in 2024 related to environmental, social or governance issues, with a majority focussing on corporate governance. This surge in activist activity reflects emboldened activists, with more campaigns reaching the public domain and an ever-growing need for a company's board to clearly articulate its strategy to shareholders and wider stakeholders, including major creditors. Alongside the growth in equity activism, we also see evolving activist activity on the debt-holder side, with a number of high-profile debt activist stories which have carried into 2025.

This instalment of "In the Know" will reflect on the debt considerations arising from equity activism, look at recent debt-holder activism, and conclude by contemplating future developments with the two styles of activism.



## Equity activism

### Tactics

The first step in an activist campaign will invariably be a private approach. This is often with the caveat that the activist will reserve the right to publicise the initial letter to the target's board should it deem this necessary. At this stage, board engagement with the activist is important with many campaigns being resolved behind closed doors.

Where the campaign does spill into the public domain, strategies usually include an open letter to shareholders or publishing correspondence with the board, as well as often posing challenging questions at general meetings or requisitioning resolutions (e.g., to seek a change in directors or corporate strategy). An activist may request the target's share register in preparation for its contacting key shareholders (e.g., via traditional methods or social media).

Activists can also use a stake in the target to influence a shareholder vote. As an option of last resort, legal action may be threatened or commenced, most frequently in the form of a

claim for unfair prejudice or a derivative action against the relevant directors.

Many activism campaigns never reach the public domain, but those that do are often driven by relatively small equity holders (less than 5%) who are experienced in running effective public campaigns. However, in a live takeover scenario, or in a scenario where a major shareholder disagrees with a specialist activist, it can be traditionally less vocal shareholders who speak up and themselves become activists.

From a company's perspective, mitigating the likelihood of equity activism can be achieved through a combination of continued engagement with shareholders and other stakeholders, maintenance of high corporate governance standards and by conducting strategic reviews where necessary to ensure an optimal corporate strategy is pursued to maximise shareholder value with consideration of wider stakeholder interests. Clear articulation of a corporate strategy is one of the most effective defence mechanisms against equity activists, with a recent example involving a UK listed retailer illustrating this.





## Strategies

Shareholder activists often seek to bring about change via calling for or seeking to influence one or more of the following:

- **Sale of part:** In 2024, almost half of all global activist campaigns had M&A as an objective, with disposal being a common proposal where a particular business unit is seen to be underperforming. Recent cases of this include business units with significant contingent liabilities (e.g., due to litigation) or a proven history of losses with no immediate prospects of a turnaround. Considerations of a disposal under a group's financing arrangements include implications for covenants such as asset sales, change of control, restricted payments/investments and debt incurrence, in each case depending on the structure of the sale. A successful disposal may generate cash proceeds to improve a target's balance sheet and creditworthiness.
- **Spin-off:** This is a carve-out and listing or sale of a business which is likely driven by an activist's view that the split business will be valued higher than as a standalone entity. We observe instances of spin-off proposals by activists following M&A which has underdelivered, and where it is argued the spin-off could be used to "reverse" the failed acquisition and improve share price performance. In a recent campaign targeting a well-known food business, an activist called for the spin-off of a business that the target had acquired during the market boom. The campaign was driven by a dramatic reversal of market conditions and a resulting view that the acquisition had led to underperformance in the target's share price. Such transactions could require new financing or a recut of any existing group financing documents to accommodate the new group, in addition to raising similar covenant considerations as the sale of part of the group noted above.
- **Purchasers of spin-offs resulting in a sale** may also want to leverage their purchase by incurring debt.
- **Delisting:** Of increasing relevance to listed companies is the potential for an activist to call for a delisting from the stock exchange on which the shares are listed, or transfer of a main listing overseas while potentially maintaining a secondary listing where the shares are currently listed. This is especially pertinent for dual-listed companies that have evolved to generate a majority of revenue in overseas markets and, therefore, may lack the natural draw to the main market in which they listed, which they once had. In recent campaigns, activists have cited the benefits of simplified governance and cost efficiencies from consolidation of a company's listing structure; other factors include improved liquidity and tax incentives specific to the overseas jurisdiction. Given the ongoing attention equity markets are receiving in relation to global competitiveness, this could become an increasing feature in activist campaigns. Implications to debt financing documentation would depend on the structure of the transaction and should be carefully considered prior to delisting, relisting or dual listing.
- **Corporate reorganisations:** These are proposals for business divisions to be reorganised within the group. The main drivers of corporate reorganisations are to increase (i) customer focus, (ii) accountability and responsiveness of decision-making, (iii) shareholder value creation or (iv) prepare for a spin-off (see above). The implications of such an approach for debt include consent requirements under existing financing arrangements or the need for new separate financing arrangements. A target may also take this opportunity to consider its debt position: whether it is overleveraged or is underleveraged and could incur additional debt to facilitate a dividend recap to return cash to shareholders.

## Campaign drivers

The aim of any activist campaign is to increase a target's equity value (either on a public market or via a take-private transaction), whether in the near, medium or long term, and whether that be by generating operational efficiencies, positioning the target to capitalise on market trends such as sector consolidation, avoiding future losses and liabilities or using disposal proceeds to improve the target's balance sheet position. Increasing a target's equity value also adds a cushion of protection for debtholders who would get paid back ahead of equity holders.

Of course, much of the narrative on equity activism focuses on the resulting impact on share price. What is not as often reported is how equity activism can impact lenders or noteholders, whether that be because of the price impact on debt or notes, the covenant impact of disposals, spins or returns of value, or the ability/appetite of the target company to raise more debt.

Activist campaigns may also result in ratings downgrades for issuers which may impact portability and other covenants in debt documentation. Of 26 activist campaigns surveyed by a prominent ratings agency in 2020, 21 were credit negative (including 12 ratings downgrades), with only five being credit positive. The majority of those campaigns which caused downgrades were M&A related, and, in some cases, it took many years for the ratings impact to materialise given that complex M&A takes a long time to originate, design and then complete. This illustrates the potential contrast between the short-term aims of equity activists and longer-term goals of institutional shareholders and debtholders.

## Debtholder activism

Increasingly, we have seen activists use debt as an alternative to equity in their strategy to generate returns. The common approach is to purchase debt at a discount with the aim of influencing the target or restructuring process to improve the return to above the discount. Such activists may also inject new capital via senior debt, with potential equity-linked or other value-accretive kickers.

### Strategies

There are several strategies that a debtholder activist might employ, including the following:

- **Influence restructuring/insolvency:** We have seen examples of creditors banding together form pre-emptive cooperation agreements with other creditors to improve leverage against the issuer. This has led to improved outcomes for creditors. For example, in a recent scenario, a group of creditors holding 80% of an issuer's bonds, formed a pre-emptive pact to improve their collective bargaining power against the issuer. From this stronger position, the group of creditors negotiated tighter covenants loan documentation and security for the bonds. In an insolvency context, presence on creditor committees will enable a debtholder activist to seek to influence the steps a liquidator or administrator can take.
- **Uptiering:** This is another strategy a debtholder activist may adopt to secure improved returns to debt holdings. This practice is more common in the US than in Europe (owing to contractual and market factors). In an ongoing high-profile example, a well-known activist purchased bonds for around 70 pence in the pound. The same activist and other bondholders obtained court approval for a restructuring plan involving an injection of GBP 3 billion which will rank on a "super senior basis", thus instigating a cross-class cram down in relation to class B and subordinated creditors.



- **Repayment at par:** We also note instances where debtholders acquire debt at a discount in companies and seek to exercise cessation of business clauses, profiting when debt is repaid at par. Cessation of business clauses are commonly found in investment-grade debt. Several ongoing campaigns were started by debtholders following disposals of business or significant assets by an issuer. The first example of this strategy involved a European chemical company which spun off one of its significant businesses and was forced to repay certain bonds at par. Notably, the spun-off business generated the majority of the company's revenues, and bondholders argued that this transaction was, therefore, an event of default under the cessation of business clause.

## Future developments: an exchange of ideas

As activism develops, we expect to see debtholders adopt more of the strategies traditionally adopted by equity activists. This might include greater visibility via public campaigns as well as litigation. We also anticipate there may be examples of issuers being subject to pincer campaigns, first by equity activists seeking spin-offs, disposals and other significant transactions, and shortly afterwards, by debtholder activists, specifically making use of cessation of business clauses in debt to seek accelerated repayment.

There may also be the potential for greater use of a target's debt by shareholder activists in a pincer movement to exert greater pressure on a target board.

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