Does Investor Climate Activism really work?

Introduction to Activism and Climate Activism

Activist investing in the broad sense is the act of a shareholder using his equity stake in a corporation to push through change at the firm. This type of investing can also apply to other assets, such as defaulted Government bonds, but we will only focus on corporate activism in this article. The timeline of a successful conventional activist campaign would start with the investor buying stake in a firm. Often, a stake of less than 10% in the firm is sufficient to give the investor enough heft to influence the firm's actions. In some cases, such as when the firms are very large and hence valuable, stakes as small as 1-2% may be sufficient. Once the stake has been acquired, the investor will try to improve the firm's financial performance via changing management, the business model, selling off business lines, or other things. If successful, this improves the firm's performance, which entails a better share price, leaving the investor with a profit.

In some cases, the activist investors are welcomed by the firm's management and constructive discussions are had regarding to how the firm can improve. Most often, however, a conflict between management and the investor ensues, which is carried out in proxy battles, publicity campaigns and more. Past actions of activist investors, especially of those in the 1980s, tainted the reputation of activism. During that time, corporate raiders such as T. Boone Pickens and Carl Icahn would engage in politically unpopular actions. For instance, they amassed shares in a firm and then forced it to buy them back at a premium relative to the market price. Today, however, most activists pursue tangible improvement of the firm's business. Notable recent examples of activist campaigns have been Elliot Management's campaign at Softbank, making it sell off assets and increase dividends, and Third Point's attempt at breaking up Shell. Also, activism is one of the best performing hedge fund strategies in recent years.

Climate activism differs from traditional activism, as climate activists try to improve the firm's climate impact, rather than management or finances. Also, not all climate activists are purely motivated by money when they launch their activist campaigns. Naturally, however, most fund managers must pursue profits when making their investment, as that is their investment mandate. Third Point, for example, will try to improve Shell's valuation through separating it into a highly valued renewables firm and a cash-flow rich oil company. As the ESG rating of a firm correlates positively to the amount of institutional money that's allowed to invest in it, the motives of helping the world climate and making money frequently align for investors.

Recent Climate Activism battles: Shell, McDonald's and AGL Energy:

Third Point and Shell

During Q2 2021, Third Point, the Wall Street activist investment advisory firm helmed by Daniel Loeb, began amassing a $750mn stake in Shell corresponding to a 0.4% stake in the company in order to achieve and capitalize on corporate change. Indeed, the activist firm later proposed in their letter to investors on October 27th 2021 to split the oil supermajor into multiple standalone companies. This is due to the ineffectiveness of incoherent strategies pushed by different competing stakeholders as some wanted Shell to invest aggressively in renewable energy while others wanted it to prioritize return on capital and its legacy oil and gas business. The letter argued that splitting up the oil giant would help the firm achieve its full potential. Third Point insisted that Shell's shares were trading at under 4x next year's EBITDA and ~8x earnings at "strip" prices with a ~35%

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discount on most metrics to competitors. The letter also came less than six months after a court in The Hague ordered the now UK-based company to speed up its plans to cut CO2 emissions and among a general pressure by the International Energy Agency to reach net-zero carbon emissions by 2050.

The move recalled also the successful six-month proxy campaign waged this spring by Engine No. 1, an upstart fund manager which nominated and elected three directors on the board of Exxon Mobil with just a 0.02% stake. However, Third Point had a much more passive approach through meetings and interactions with Shell.

Third Point's recommendations are often implemented with the two most recent examples being Prudential Plc, which spun off its US business following Third Point's recommendation to do so, and Intel, which named a new CEO shortly after Third Point's Q1 2021 investment. The activist firm's recommendations are yet to be implemented in Shell however. The suggestions have faced much criticism by executives and shareholders - the split hasn't been implemented and the company is sticking to its green transition plan.

However, Shell's decision seemed to pay off with higher adjusted earnings for 2021 of $19.3bn from $4.8bn a year earlier when the pandemic hit oil demand. Earnings have been driven by its integrated gas, renewables and energy solutions division which generated more than 63 per cent of group earnings in the fourth quarter as an energy crunch in Europe pushed up natural gas prices. The company will step up its distributions to shareholders with a commitment to buy back $8.5bn in shares in the first half of 2022 and raise its dividend by roughly 4 per cent to 25 cents a share in the first quarter. The profits mark a turnaround for the group, after a disastrous 2020 and a challenging 2021, with the ruling by the Dutch Court and Third Point's letter putting a lot of pressure on the future of the company. These results will dismiss the remaining doubts of shareholders regarding a breakup and so eliminate the chance of a split up in the near future.

Carl Icahn and McDonald's

Despite the failure of Third Point, activism investing has not been discouraged. Carl Icahn is taking on an unusual fight against the $187bn fast-food heavyweight McDonald's aimed at changing the way its suppliers treat pigs while owning just 200 shares worth roughly $50,000.

The investor is asking the burger chain's US pork suppliers to end the practice of keeping pregnant pigs confined in small crates for most of their pregnancy. In 2012, McDonald's promised it would stop buying from suppliers that confine swine in cramped quarters. However, by the end of the year it will still buy 10 to 15 per cent of its US pork from pigs kept in what it describes as "gestational crates". Icahn has joined up with the Humane Society of the United States in demanding action nominating Green Century Capital Management's president, Leslie Samuelrich, and Bon Appétit Management Company's strategy chief, Maisie Ganzler, to help carry out his mission on its board. With his small number of shares, Icahn's potential financial gain from the fight is barely a drop in the trough for a seasoned investor who has accumulated tens of billions of dollars throughout his career highlighting how activist investors can act purely on moral grounds.

McDonald's has argued that his request would be "impossible" to fulfill now as it would defy "veterinary science" and also referred to Icahn's campaign as a "narrow issue" noting that the company buys just 1 per cent of US pork production. The company also complained that Icahn owns only 200 McDonald's shares and has not demanded the same commitment from Viskase, the pork packaging supplier that he controls.

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It is unclear how the fight will continue and what the outcome will be. Nevertheless, the activist investor has nominated two board directors to change the treatment of pregnant sows in crates. The Humane Society pushed for a shareholder vote on the subject. But McDonald's chief executive declined to get on the phone. The fight is yet to begin.

Brookfield and Cannon-Brookes vs AGL Energy

A more by-the-book format of activism investing is happening in Australia, one that could set a new precedent for what private capital is prepared and able to do to quicken the global energy industry's transition to renewable energy and generate big returns in the process. The Canadian Brookfield Asset Management and the Australian tech billionaire, Mike Cannon-Brookes, one of the country's most prominent climate activists, have teamed up on Sunday in an attempt to buy one of Australia's biggest and dirtiest energy generators, AGL Energy, for A$5bn/$3.6bn. The company has three ageing coal-fired power stations, some gas and renewable generation, and a huge energy retail business. It's Australia's single biggest emitter, making it a target for climate activists. Investors are worried about the company's huge reliance on coal, since the energy source has become increasingly vulnerable against ultra-cheap and plentiful wind and solar.

The turnaround plan by Cannon-Brookes and Brookfield would be taking the publicly traded company private and pumping $20bn into new renewables and storage, to shut the coal plants early and turn AGL into a profitable zero-emissions utility. However, AGL rejected Brookfield's offer on Monday morning, saying it undervalued the company. The company argued that its own plan to spin off the coal plants into a new company, urged also by BlackRock in 2020, one of AGL's major shareholders, would create value that was not yet factored into its share price. The company also added that the proposal does not offer an adequate premium for a change of control and is not in the best interests of AGL Energy shareholders. However, Brookfield and Cannon-Brookes have been clear regarding the fact that AGL's share price has nowhere to go but down and are ready to go hostile.

Although Brookfield's preference was to get the board's approval, the consortium would take the deal to big investors regardless of its stance, as they believe that the capital required to replace AGL's coal plants with renewable generation is beyond what AGL can achieve in the public markets. The final goal is to shut down all AGL's coal generation and reach net zero emissions by 2035, a dozen years earlier than AGL's target. The difficulties could lie in convincing current shareholders as AGL is largely owned by small retail investors, so getting a critical mass of investors on board through back-room deals might not work.

At least one major shareholder — BlackRock, which owns 4.1 per cent of the company — could prove willing. In 2020, BlackRock voted against the AGL board on a shareholder resolution calling on the company to bring forward the closure of its coal plants. Getting BlackRock onside would clearly boost the bidders' chances.

Brookfield is not an activist and its takeover bid at AGL has not gone hostile - yet. However, if this attempt, by Brookfield and Cannon Brookes, to decarbonize and transition AGL in one of the biggest renewable energy producers will demonstrate that value can be created by killing off carbon-intensive businesses — private equity could become a value weapon in the fight to combat global warming.

Are Activism fights effective?

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Activist campaigns seem to be successful when they highlight inefficiencies connected with poor ESG standards and when these are fixed they can bring higher returns with better standards.

For example, Engine No.1 highlighted the failures of Exxon's climate approach and its financial underperformance and proposed a solution to it. The activist battle seemed reasonable and was in the end welcomed by shareholders. On the other hand, Third Point asked for a breakup which would be very difficult to achieve and to convince shareholders of its worthiness. Splitting up Shell would involve high organizational costs and leave shareholders discouraged by uncertainty. However, Third Point's letter did help Shell in understanding how synergies between their gas, renewables and energy solutions divisions were not properly exploited, due to the vastness and complexity of the company, hence the very high profits in 2021, which the rebound in oil and gas prices can only partly justify.

Icahn's battle is yet to start but as changing suppliers for McDonald's is a cost the treatment of pigs will probably change in the short term only if a large enough backlash will occur and so hold the company accountable. Otherwise, the company will pledge to change suppliers in some time. In this case, the small stake owned by Icahn, even if meaningless compared to how big McDonald's is, was not an obstacle to promoting change. Engine No.1 also was able to win the proxy campaign against Exxon with a very small share but the problem they brought in front of the board was of much greater urgence and also offered the company a way to expand into greener energy, granting itself a brighter future compared to its peers. In McDonald's case however, the company is holding itself to the standard treatments every other fast-food chain has, there is not enough pressure on this industry to improve.

Finally, the more traditional by the book activism strategy of Brookfield and Cannon-Brookes could be as powerful in convincing the major shareholders of the Australian Energy Giant that a faster energetic transition is in the best interests of everyone. This is especially true in light of the progress that Origin, its biggest rival, has made. The key aspect remains the reaction of BlackRock (one of the major shareholders)to the proposal.

In conclusion, although by-the-book strategies still seem to have a positive outcome even activists with small stakes, together with the help of more awareness brought by social networks and media, can exercise enough pressure to create change. Also, as shown by Third Point, often smaller activists will not achieve their desired outcome but are still able to push for more efficiency and better results and so bring more awareness to certain issues.

TAGS: Activism, ESG, Green, Climate, Shell, Exxon, Energy, Renewables

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