2016

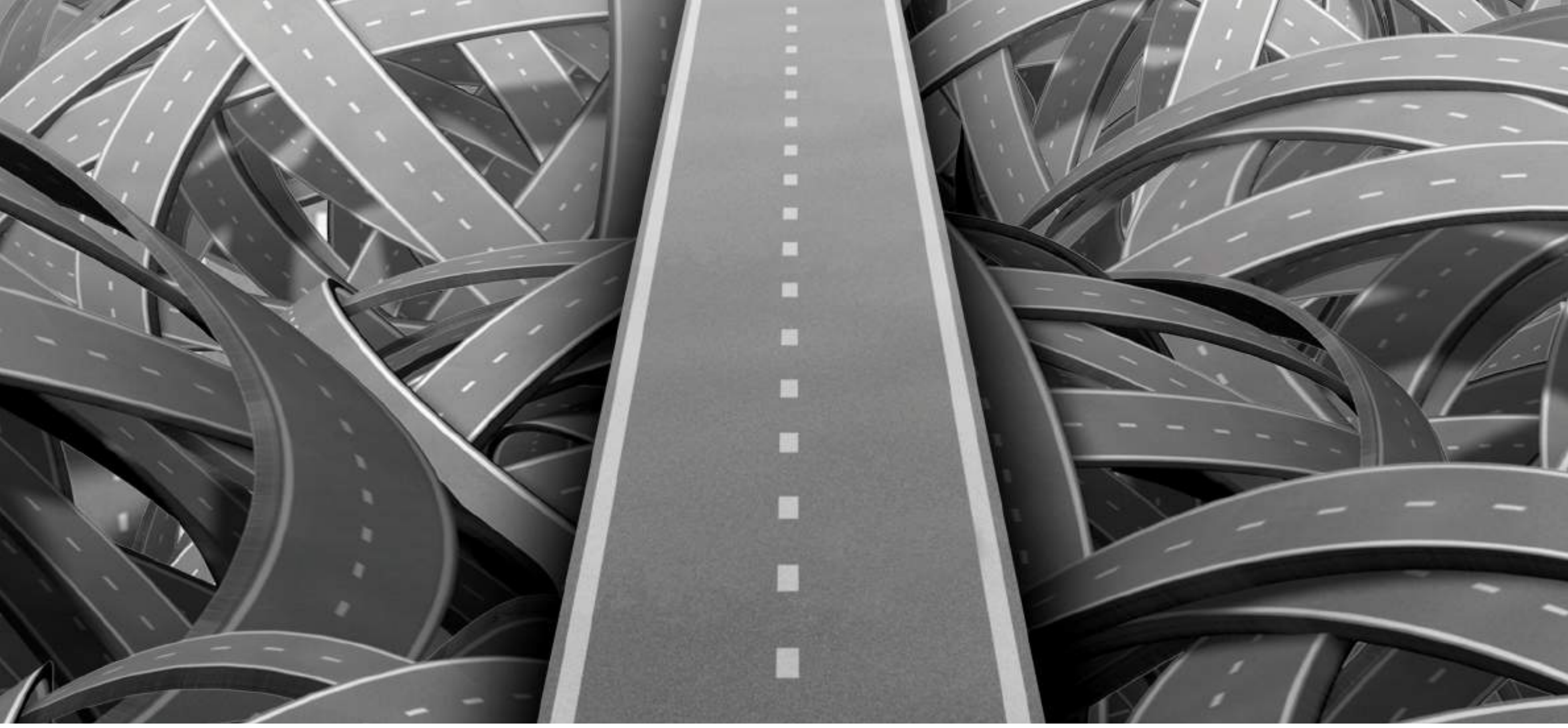
ACTIVIST INVESTING

An annual review of trends in shareholder activism

Activist Insight

In association with

Schulte Roth & Zabel



UNPARALLELED EXPERIENCE

"Schulte Roth & Zabel … [has] come to dominate the activism market."
— REUTERS

"… Schulte Roth & Zabel partners … have established themselves as go-to lawyers for activist investors across the United States."
— THE AMERICAN LAWYER

"SRZ's clients in the U.S. include several of the highest-profile activist managers …"
— FINANCIAL TIMES

"Dissident investors are increasingly looking to deploy deep capital reserves outside their bread-and-butter U.S. market, driving Schulte Roth & Zabel LLP to bring its renowned shareholder activism practice to the U.K. – a jurisdiction experts say is on the brink of an activism boom."
— LAW360

Schulte Roth & Zabel is frequently named one of the top law firms for providing legal advice to activist funds.
— ACTIVIST INSIGHT AND THE WALL STREET JOURNAL

Schulte Roth & Zabel

Schulte Roth & Zabel LLP | New York | Washington DC | London | www.srz.com

Editor's foreword

Activist Insight's Josh Black on a busy year for activism.

The end of another year of increased activist activity provides a useful opportunity for reflection. What changed in 2015 that wasn't already in flux and which trends have been arrested? Is it fair to say that activism will be a different beast in 2016 and beyond?

One thing that no longer seems surprising is that activism continues to increase, affecting 551 companies in 2015. This growth has been dramatic and sustained in North America, uncertain in Europe and stop-start in Asia. Nonetheless, the period of turmoil in financial markets at the end of the year suggests this is not likely to be a deterrent to further increases in activism. Indeed, a growing number of activists are "first-timers" or occasional practitioners of the trade. It is hard to predict the implications this trend may have.

Performance-wise, 2015 was not a good year for activists. The Activist Insight Index was down 3% at the end of the third quarter, and activist-targeted US stocks fell by an average of 8%, including dividends, through the year-end on an un-weighted basis. What is true for activists is true for the asset management industry as a whole, however, and seasoned campaigners appear resilient to the sort of shocks they felt in 2015. Many activists had quite reasonable performance in 2015, and stocks like Microsoft, Darden Restaurants and General Electric added value.

Moreover, where activists made mistakes, it was far from clear that activism was the cause of their trouble.

> "Where activists made mistakes, it was far from clear that activism was the cause of their trouble"

False starts to a recovery in commodity prices, questionable business practices in the pharmaceuticals sector and for-sale companies with no buyers have all played their part. Investors in activist funds expect their managers to foresee and avoid pitfalls such as these, but critics of activism cannot infer that shareholders may only play a nefarious role by intervening in corporate affairs.

Despite activists seeing an even greater number of the changes they called for enacted, the bar continues to be set high; the proxy contest at DuPont, where a series of changes at board level and operational promises ensured Nelson Peltz's defeat, highlights that point. Qualcomm, Yahoo, Yum! Brands and Rolls-Royce Holdings have not folded at the sight of an activist, but have proceeded at their own pace. Even so, companies will be reviewing their options more frequently in anticipation of activists. It is not easy to imagine the merger of DuPont and Dow Chemical in an environment devoid of activists, for example, but equally unlikely that it would proceed against the better judgment of directors and executives.

Thus, a fascinating year gives way to a new environment in which all shareholders are expected to play a greater role in corporate strategy. Activists will continue to be influential, but a lot will hinge on their relationships with CEOs and directors, especially when their ideas are complex. Some activists will win big, others will fall short, but the financial ecosystem will continue to adapt to their presence. Along the way there will be plenty to discuss—so much the better for us journalists—and we at Activist Insight look forward to supplying the data that helps shape that debate.

I would like to take this opportunity to thank all of our sponsors, but Schulte Roth & Zabel in particular for again sponsoring this Review and inviting me to speak at their seminars in New York and London over the past year. It has been a busy and exciting year at Activist Insight, in which we have expanded our coverage and added new features to our suite of products, and 2016 offers the promise of even greater developments. ■

Activist Insight

Contents

The Activist Insight Activist Investing Review 2016, in association with Schulte Roth & Zabel.

24

MANAGING EDITOR:
Josh Black

ACTIVIST INSIGHT CONTRIBUTORS:
Nick Arnott, Kerry Pogue, Adam Riches, James Martin, Husein Bektic, Adrian Gilbert, Daniel Davis, Kwaku Ankamah, Olivia Davies, Paolo Frediani, Ashton Rowntree

WITH SPECIAL THANKS TO:
Marc Weingarten, Eleazer Klein & Jim McNally at Schulte Roth & Zabel LLP

Activist Insight wishes to thank all contributors and those who made themselves available to be interviewed for this report.

PUBLISHED BY:
Activist Insight Limited
26 York Street, London, W1U 6PZ
+44 (0) 207 129 1314

www.activistinsight.com
info@activistinsight.com
Twitter: @ActivistInsight

Image credits: (All images provided by Shutterstock) p16, Citrix: zimmytws; p17, PepBoys: Ken Wolter; p17, Suzuki: Charnsitr; p18, Advance Auto Parts: Jason Grindle; p18, Pepsi: Mahathir Mohd Yasin; p19, Rolls Royce: Jonathan Weiss; p19, MGM: Charnsitr; p20, Viacom: 360b; p20, Canadian Pacific: Serjio74; p33, Samsung: TK Kurikawa.

Schulte Roth & Zabel

WWW.SRZ.COM

The activism surge continues

Schulte Roth & Zabel Partners Marc Weingarten and Eleazer Klein, Co-Chairs of the firm's global Shareholder Activism Group, on what was learned in 2015 and what to expect going forward.

Any worries that the ever-growing inflow of assets to activist funds would lead to a dearth of sufficient opportunities in 2015 have proven unfounded. In 2015, activists found opportunities to deploy their capital around the globe with great success.

It's not all about the vote

Trian Fund Management's campaign at DuPont in 2015 served as a stark reminder that an activist's success is not always measured solely by the votes cast. DuPont took many of the steps Trian was urging in response to its campaign before the annual meeting. And while headlines in May declared DuPont's CEO Ellen Kullman the victor, by October the company's stock was down over 30%. Kullman left the company soon thereafter and, by December, Trian helped promote a game-changing deal between DuPont and Dow Chemical. The outcome of Trian's campaign stands as a lesson that management would be wrong to assume it can ignore an activist who may lose a battle but can still win the war.

Year of the spin-off?

There is no doubt that activists served as catalysts for spin-off activity. In 2015, eBay completed the spin-off of PayPal following pressure from Carl Icahn. Additionally, The Manitowoc Company agreed to split its cranes and foodservice businesses, and Gannett completed the spin-off of its publishing business, both following Mr. Icahn's investments in those companies' shares. Meanwhile, Yahoo shelved plans for its Alibaba spin-off following pressure from investors, like Starboard Value, for Yahoo to sell its Internet business instead. Even DuPont and Dow Chemical's merger plans contemplate a split into three different businesses, following calls by Trian and Third Point.

> "The 'era of activism' has no end in sight"

Shareholders sans frontières

While the US remains the undisputed epicenter of shareholder activism, we've seen an increase in the number of activist campaigns in Europe and elsewhere around the globe. A significant number of European-based shareholders launched new campaigns in 2015, and more US-based activists have taken advantage of opportunities in Europe.

As the role and presence of proxy advisers have risen and as traditional European investors have become more open to support activists who respect cultural norms, activists have become more willing to invest in European opportunities. In 2015, French media group Vivendi agreed to increase dividends by more than $1 billion after being confronted by P. Schoenfeld Asset Management, and ValueAct Capital Partners became the top shareholder in Rolls-Royce Holdings, an iconic global company. Some US activists have even been willing to utilize their strategies elsewhere around the globe, as demonstrated by Elliott Management's highly public attempt to block the takeover of South Korean construction company Samsung C&T.

What to expect for 2016

The "era of activism" has no end in sight. With the increased capital available to established activists, many new entrants into the sector and the increasing willingness of investors who are not dedicated activists to wage campaigns, the trend for increasing activist activity in the US, and globally, will surely continue in 2016. ■

With offices in New York, Washington D.C. and London, SRZ is a leading law firm serving the alternative investment management industry, and the firm is renowned for its Shareholder Activism practice. In October 2015, SRZ hosted its 6th Annual Shareholder Activism Conference in New York and in November 2015, SRZ and Activist Insight hosted a seminar in London discussing "Shareholder Activism in the UK."

Value investing vs. activism; are they the same thing?

Cas Sydorowitz sees a convergence of two disciplines.

Who would you rather have on your share register, a value investor or an activist? Most CEOs would probably opt for the former, but seeing an activist invest in your company might be more of a compliment than you think. What activists and value investors have in common is a mission to find good companies which are not fully appreciated by the market at large. Both approve of sturdy revenues, "moats" that prevent rivals from overtaking and the potential for growth. In this age of mass information, it's hard to find a stock that's simply underappreciated. As a result, both value and activist investors will likely be searching for something that needs a little fixing.

Sometimes the flaw is management, the decisions they make or don't make, or their knowledge and competence in specific industries. Yet it could just as easily be an overly conservative capital structure, such as a large cash holding or a low dividend pay-out ratio, bad governance, such as the independence of the board, or a remuneration policy that pays as much attention to long-term value creation as short-term share performance.

One of the biggest differences between an activist and a value investor is that the former will often have a far more focused portfolio, with perhaps 7-15 stocks, while many value investors will have hundreds of stocks they are looking after in their portfolios. Having a small portfolio allows the activists to spend more time and go into greater depth in the research they undertake, as well as to engage with the company regularly.

> "Having a small portfolio allows activists to spend more time on the research they undertake"

Andrey Kruglykhin, CEO of the newly formed natural resources-focused Highgate Capital, emphasizes the importance of the "ferociously detailed analysis and due diligence needed" to support "an active engagement with the company and its shareholders and other stakeholders to unlock value which is already there." The private equity-style analysis is done from the outside-in, to ensure that there is a path to narrowing that discount.

They do this extraordinary research because they want to come across to management and other shareholders as well-informed about the company, but also because they have to justify their fees to their own investors. Most value investors don't have the budget to run the same forensic analysis.

Another difference is that activists are often paid based on the 2% of assets under management and 20% of profits model common to the hedge fund industry. That, combined with their concentrated portfolios, means that they are keen to see potentially value-enhancing initiatives enacted quickly. Executives should remember that it is not board seats or pyrrhic victories that matter to activists at the end of the day, but returns.

Activists, with their management consultants, headhunters and private investigators, will often be highly confident about the value that is being hidden. That also makes them determined to unlock value, and they will hire lawyers, PR firms, proxy solicitors and headhunters for a potentially public fight and to engage with the company's shareholders to elicit their support rather than sit back and wait. So while value investors and activists look to identify similar companies mis-priced by the market, the fundamental difference is still how far they will go to narrow that discount. Understanding how the buy-side gets paid will enhance corporates' sensitivity to their shareholders, and their ability to respond to an activist. ■

Cas Sydorowitz is the CEO of Georgeson Corporate Advisory, a provider of proxy, analytics and transaction support for companies around the world.


Would you make the right moves?
When protecting against activism, your preparation is crucial:
• Profiling the activist
• Assessing the voting risk of the institutions and proxy advisors' influence
• Weighing up the influence of the retail holders
• Crafting and delivering the message to activate the right investors and drive votes
Let us prepare your activist strategy:
Cas Sydorowitz
bd@georgeson.com
+44 (0) 870 703 0302
www.georgeson.com
Georgeson
A COMPUTERSHARE COMPANY

A brave new world

Shareholder activism in 2015 and beyond.

Activism continued to grow in 2015, setting new records. Overall, the number of companies subjected to a public demand by an activist grew 16%, to 551, with growth strongest in US, Asian and Australian markets. A total of 397 activists made public demands of listed companies worldwide during the year, up 32% from 2014's total. Nor is this remarkable leap in the number of shareholders engaging publicly with companies an aberration—the number of "active" activists grew 38% between 2013 and 2014, according to Activist Insight data.

In a year in which markets have been decidedly choppy, the theory that activism is primarily a bull-market strategy faced its stiffest challenge.

Methodology: data in this Review refer to companies publicly subjected to demands by a current shareholder. Unless explicitly stated, activist short campaigns are excluded from the data.

“Investors across the board are becoming much more engaged with companies they own”

Too much of a good thing?

Strikingly, more and more companies are being targeted not by the “usual suspects,” but by what Activist Insight describes as “occasional” activists. From an average of 37% between 2010 and 2014, the number of activists making a demand in 2015 that fall into this camp leapt to 51% (see chart). Primary and partial focus activists, while setting out to shake up a broadly similar number of companies in real terms, saw their combined share of the total reduced by five percentage points.

“Investors across the board are becoming much more involved with the companies they own,” says Bruce Goldfarb, CEO of proxy solicitation firm Okapi Partners. “This doesn’t always mean running proxy contests or publicly challenging the management. It often means working behind the scenes with the company and the board to help shape the long-term strategy.”

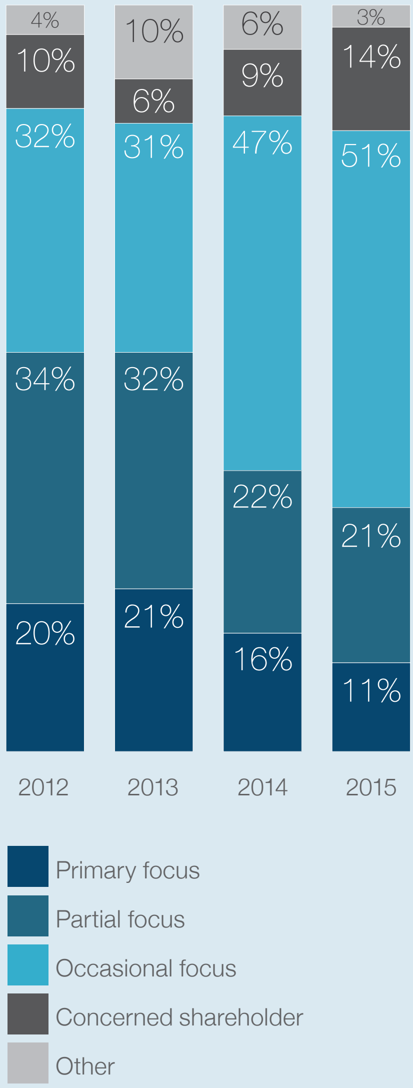
Those trying activism for the first time can be forgiven if they think others make it look easy. Just under 61% of resolved activist demands were at least partially satisfied, according to Activist Insight data. That figure rose to 69% in US campaigns, the highest since 2010.

Paradoxically, that may spell difficult times ahead for activists. Observers talk of a new relationship between investors and issuers which has yet to resolve itself. Some popular activist ideas, such as returning capital to shareholders or reviewing opportunities for strategic transactions, are now regularly up for discussion, with the result that activists could have to offer greater insight to be welcomed into the boardroom. “All large shareholders are engaging with management now, but management teams would rather deal with investors who focus on long-term value-creation,” says Ali Dibadj, Senior Analyst at Alliance Bernstein.

That creates the risk that all but the best activists could be frozen out by better dialogue with major investors. “White squire” investments at Avon and NCR, in which private equity firms bought a strategic stake to block an activist challenge, illustrate the point. Alternatively, “friendly activism,” such as Trian Fund Management’s $2.5 billion stake in General Electric, where a management-led transformation won conditional support from Nelson Peltz and Ed Garden, may light a path forward.

For management teams, the emergence of new activists without track records of winning support but perhaps with years of experience in a company’s affairs could make for difficult decisions. Will the trend for settlements continue as issuers bank on the tactical naivety of activists, or will executives allow their bluff to be called? That said, uncertainty could also apply to investors going out of their comfort zones. Indeed, in 2015, activists saw their second-lowest proportion of at least partially satisfied demands at European companies since 2010, at a lowly 54%.

Activists by focus level



This chart breaks down activists making public demands at one or more companies in a given year. Primary focus activists run a concentrated portfolio and engage most of the companies they invest in. Partial focus activists may target several companies per year, but invest in dozens. Occasional activists will engage management every so often, while concerned shareholders are typically responding to unexpected developments.

551

companies were publicly subjected to activist demands in 2015

Activism goes East

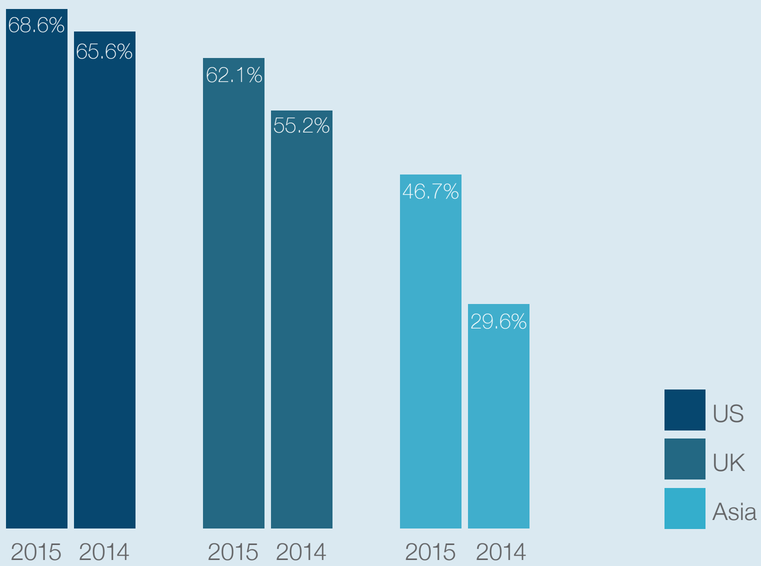
Activity in the US, which accounted for just under two-thirds of companies targeted in 2015, has continued to grow despite predictions that the market would become saturated, driving funds overseas. "There has been talk of activism migrating overseas, but the fact is, the US is a very large market," says Jim Rossman, who heads the activism defense practice at investment bank Lazard. "Events, such as a change in the price of oil, or the slip in the Chinese economy, can expose value."

Even so, other jurisdictions attracted much greater attention from activists than in years past. The number of companies targeted in Australia grew 27%, to 57, while Asia saw an influx of foreign activists, the number of companies targeted by non-domestic activists rising from 10 to 20 (only nine companies faced demands from activists headquartered in the same country).

Japan remains one of the most popular destinations for shareholder activists in Asia, although most are more reluctant to disclose their demands in advance. Shifts in the country's corporate governance profile, including a new stewardship code, tougher return on equity targets from Institutional Shareholder Services and moves to a "comply or explain" governance code for issuers have many believing that activism can take root in the near future, though markets are also likely to have an impact.

California Public Employees' Retirement System (CalPERS), a huge US pension fund, is already planning to make the most of Japan's growing openness to corporate governance campaigners. In a September 2015

Success rates of demands by region*



Not only is the US market the busiest one for activists, it is also the one where shareholders have the most success in getting management to address their demands. Barring Continental Europe, most regions saw greater acceptance of activist demands, with the most striking change in Asia. A slight improvement in outcomes at UK companies will provide encouragement to ValueAct Capital Partners, currently seeking a board seat at Rolls-Royce Holdings.

**Percentage of resolved activist demands at least partially satisfied*

“CalPERS is already planning to make the most of Japan’s growing openness to corporate governance campaigners”

presentation, it said it would engage with a select few companies to try and make inroads into the country’s “systemic” governance problems, including board independence, cross-shareholdings and director recruitment. Some experts refer to the plans as an example of an institution taking activism “in-house” to avoid tying its fortunes too closely to hedge funds.

For Hitoshi Sugibuchi, CEO of Tokyo-based activism-advisory firm Sessa Partners, 2016 is likely to be a “crucial year for activists in Japan,” some of whom are already accumulating stakes in advance of the June proxy season. Yet despite a high-profile win for Third Point Partners at Fanuc and a near miss for Yoshiaki Murakami at Kuroda Electric, Sugibuchi cautions against undue enthusiasm. Fanuc hiked dividends rather than repurchasing shares, he says, and remains much more focused on its sluggish institutional shareholders, rather than hedge fund investors.

So far, Europe has seen less of an uptick, despite a steady balance of foreign and domestic activists. Including the UK, 58 companies faced a public demand from activists, up from 44 in 2014 and 54 in 2013, but down from 60 in 2012.

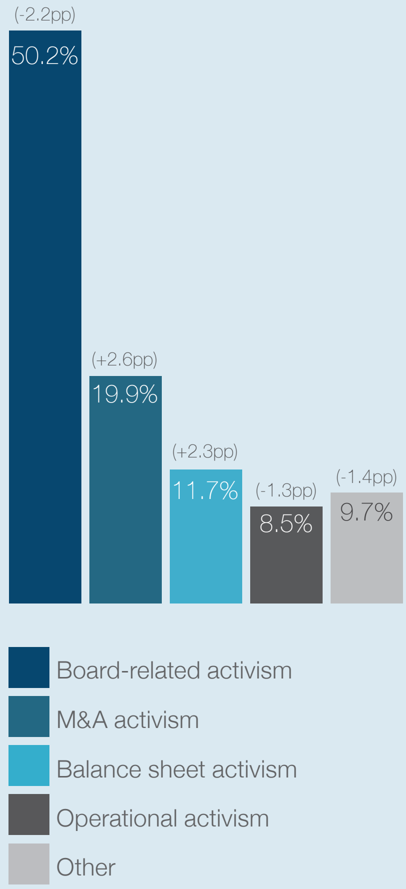
Still, some activists clearly spot opportunities, with ValueAct Capital Partners seeking a board seat at Rolls-Royce Holdings and Elliott Management triumphing in its proxy contest at Alliance Trust. On the Continent, Vincent Bolloré has been flexing his muscles at Vivendi, having seen off a challenge from P. Schoenfeld Asset Management at the start of the year and used the French media company to win board seats at perennial activism-target Telecom Italia.

Strategies and tactics

Nominal success rates on their main demands do not tell the whole story for activists, who proved most adept at selling operational demands to management teams, although these were correlated with disappointing share price performance, according to Activist Insight’s Follower Returns feature. That may be bad news for Pershing Square Capital Management, which recently made the largest activist investment ever in snack manufacturer Mondelez at $5.5 billion, although it says the opportunity for productivity improvement and margin expansion there is “vast.”

Balance sheet activism, one of the most effective but controversial strategies, rose two percentage points but remains less important than at its peak, in 2013. Indeed, Harry Wilson’s attempt to prompt General Motors into a massive buyback earlier in the year marked the last notable campaign based almost solely on returning cash to shareholders, although others continued to include similar requests among many others. Given the harvesting of cash-rich balance sheets in recent years, a much more common demand is likely to be joint ventures or sale-leasebacks for real estate, a theme common to campaigns at Macy’s, Bob Evans Farms and McDonald’s in the past twelve months.

Breakdown of activist demands in 2015



*(2014-2015 percentage point change in brackets)

Getting on the board remains a popular activist tactic, along with removing incumbent board members, de-staggering their terms and separating the Chairman and CEO roles. Together, these account for more than half of activist actions in 2015. More balance sheet activism, including calls for dividends and share repurchases, contributed to a surprising relative decline in operational demands, while in a bumper year for M&A, activists both pushed for deals and higher valuations.

397

investors made a public activist demand of a company in 2015

M&A activism, which includes investors pushing for or opposing transactions, had the lowest rate of resolved demands at least partially satisfied, perhaps because those decisions remain largely the prerogative of the board. Nonetheless, the number of demands in this category rose sharply in 2015, with developments ranging from match-making activism (such as Starboard Value applying pressure to both Staples and Office Depot to merge) to activists extolling the virtue of platform companies.

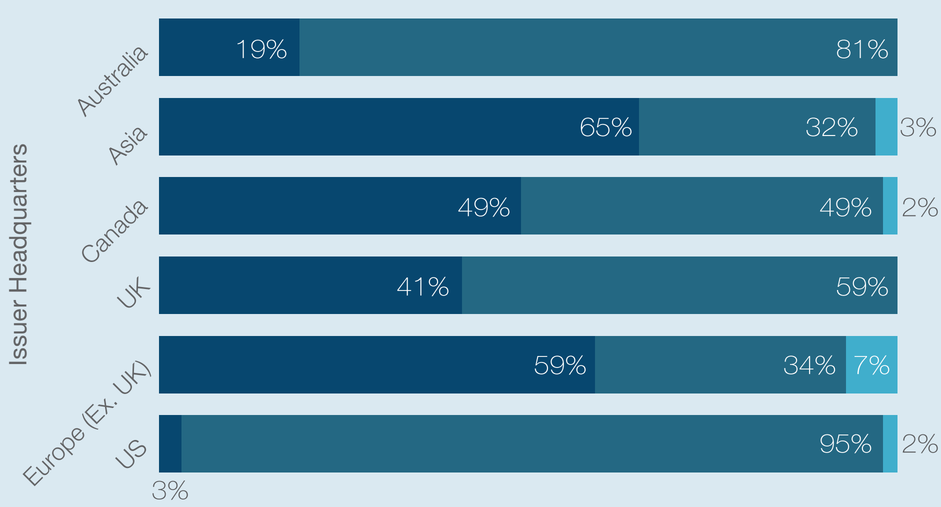
Deal-making may soon fall away regardless of activist intentions, as higher borrowing costs filter through and competition regulators sharpen their pencils, but the spate of mega-mergers at the end of 2015, including Dow Chemicals and DuPont, Allergan and Pfizer, and SAB Miller and AB InBev, and the take-private of EMC by Dell, suggests there may yet be some juice left in the market.

As Dibadj says, "Companies that have sidestepped transactions that are genuinely accretive may now be forced into them."

Changing company boards continues to be the dominant category of activism at 50% of public demands, however, with board representation for the activist or its nominees the largest single constituent of that group. As in previous years, this was more likely to come through a negotiated settlement than a contested vote, with not one of Pershing Square, Third Point, Carl Icahn, ValueAct, JANA Partners or Starboard Value going all the way to a vote. Trian, the household name that did, lost its contest at DuPont, before ultimately winning the war by getting the company to sell itself.

According to Goldfarb, the high number of public demands that

Proportion of companies in each region publicly targeted by foreign and domestic activists in 2015



While the US markets have produced ever-increasing numbers of activists, most of whom keep their compatriots under pressure, the focus elsewhere is on overseas investors providing the injection of dissent.

“Without having board representation, an activist investor may find it difficult to ensure their ideas and strategies are being implemented”

center on board seats may be in the interests of both activists and issuers. “Without having board representation, an activist may find it difficult to ensure their ideas and strategies are being properly implemented,” he says. “From a company perspective, it can also ensure the activist shareholder will be there for the long-term because board representation usually places restrictions on selling shares.”

Where next?

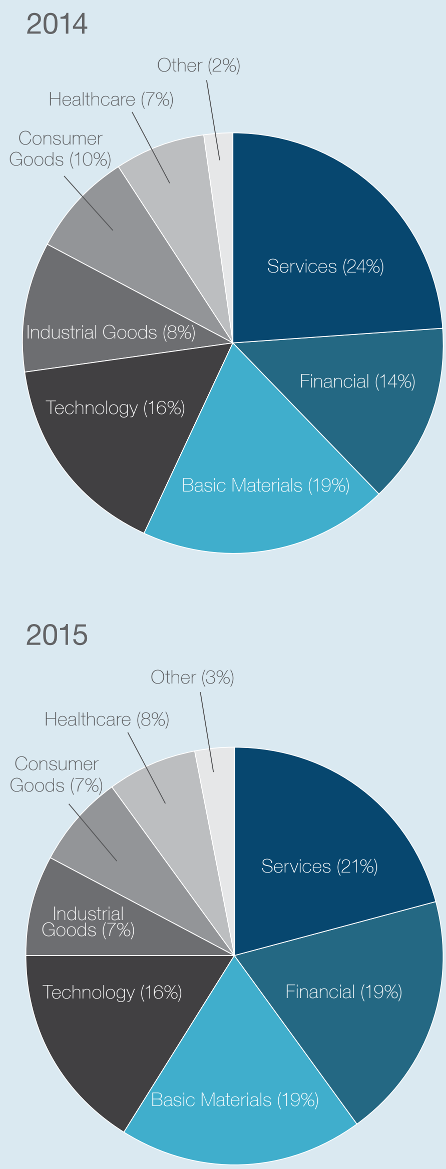
Activists bolted toward the relative safety of financial stocks in 2015, with the sector accounting for 19% of all companies targeted, compared to 14% in 2014. The trend was particularly pronounced outside of the US, where almost half the targeted companies were based, a charge led by Elliott Management. Real estate investment trusts, a specialty of Jonathan Litt’s Land & Buildings, asset managers and community banks were all well represented in the figures, while banking may also see a rise in activism in 2016. In addition to a rare campaign at a deposit-taking institution, Ally Financial, several activists including PL Capital and Hudson Executive Capital are predicting a rise in larger-bank and financial services M&A in 2016 and beyond.

In the US, services and technology continued to dominate, accounting for 24% and 19% of targeted companies, respectively, compared to 22% and 16% globally. A buoyant M&A market saw healthcare campaigns rise from 8% of the total to 11% in the US, while staying broadly flat worldwide. In addition to the likes of Third Point and Paulson & Co betting on strategic combinations, Frederic Eshelman, who learned activism as one of Pershing Square’s nominees in 2014’s proxy battle with Allergan, subsequently struck out with a contest of his own at Puma Biotech, albeit one ending in defeat.

Alex Denner, a former Icahn Capital portfolio manager and the founder of Sarissa Capital Management, told Activism Monthly Premium in June that he had held most of his capital in cash until mid-year, when a spurt of opportunities emerged. Whether that environment remains popular with generalists after the meltdown of Valeant Pharmaceuticals International remains to be seen.

Weak commodity prices contributed to a significant slowdown in basic materials activism, yet data also show a corner may have been turned. The fourth quarter of 2015 saw more public demands launched in the sector than in any period for the past three years, lending credence to a survey conducted jointly by Activist Insight and FTI Consulting that reported that energy stocks were considered the most undervalued of all sectors. Carl Icahn, who recently told his old raider pal T. Boone Pickens that he believed the price of oil would return to $70 but had no idea when that might be, has been busy making changes at Cheniere Energy in order to cash in on America’s first liquefied natural gas exports, while Canada’s West Face Capital is believed to see opportunities in the sector north of the border. ■

Evolution of activist targets by sector



Campaigns in financial and healthcare stocks grew faster than other sectors in 2015, as measured by the number of companies publicly subjected to activist demands. Both looked full of opportunities for quick returns, but basic materials remains surprisingly active, perhaps reflecting shareholder angst amid low commodity prices and the emergence of value opportunities.

A year to forget

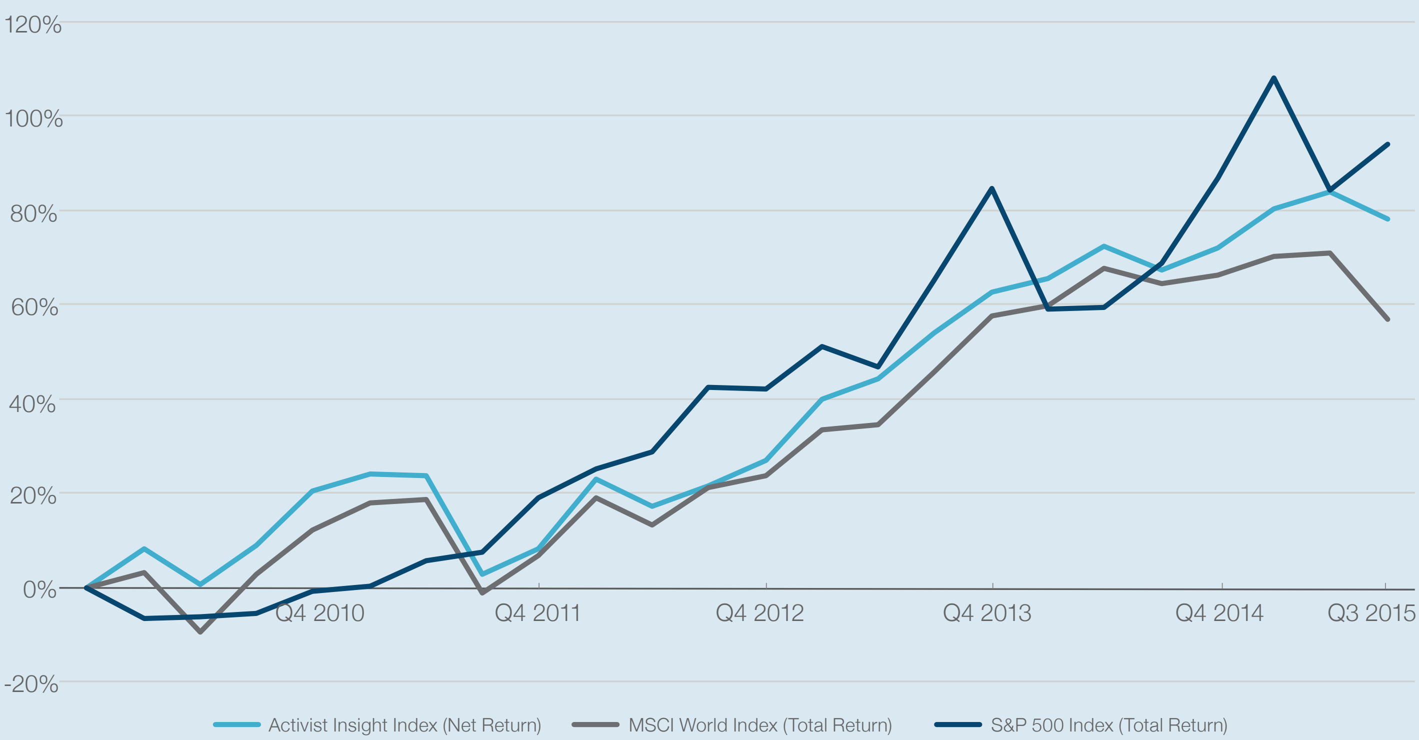
Activists' returns generated headlines for all the wrong reasons in 2015. The impact could be felt in 2016.

For more than two years, activism has been among the very hottest asset classes, flooding some of the most well-known funds with capital and generally performing better than other hedge fund strategies. Pension funds, under fire for the fees they pay alternative asset managers, have typically held onto activist portfolios while jettisoning others.

2016 could be the year this wind shifts. Activists have been hit hard by market sell-offs, weak energy prices and a still-skittish M&A market. The Activist Insight Index, compiled from more than 30 primary focus funds operating in several different markets, was down more than 3% after fees for the first three quarters of 2015, on course for a first negative year since 2011. Activist-targeted US stocks were down 7.7% at the year-end on an annualized basis, a further signifier of bad news. Yet the S&P 500 and MSCI World total return indices staged strong recoveries in the fourth quarter, and some activists finished the year strongly.

Not all stocks have behaved similarly, however. Marcos Veremis, of investment consultants Cambridge Associates, says the US activist funds he tracks showed "very variable performance" in 2015, with returns ranging from -16% to 13%. Backing the right stocks in a sharply-divided market helped—roughly half the stocks in the S&P 500 rose in 2015, while the other half fell. "On the whole, growth stocks outperformed value, which likely caused problems for some activists," Veremis adds. Nor was the problem confined to America. "Similarly, in Europe, cyclical stocks such as industrials and basic materials underperformed defensive ones by a large spread, hurting activists involved in sectors such as industrials and financials."

Compounded performance since 2010



The Activist Insight Index, based on around 30 funds from around the world, has been a strong performer since 2010, coming closer to America's S&P 500 Index than the MSCI World Index. Since the beginning of 2014, however, its performance has been notably less correlated with either index. Yet with few sustained losses, a recovery may be around the corner.

“A broad sell-off could reveal a mismatch between the assets and liabilities of a number of new entrants and smaller funds”

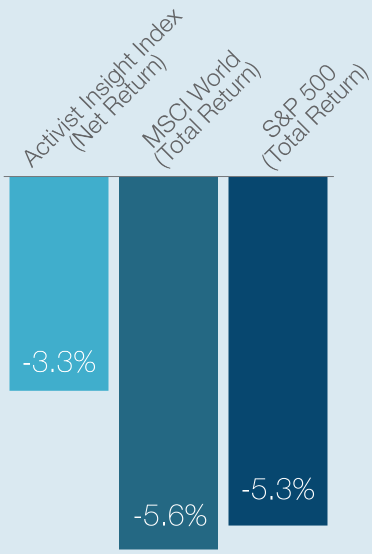
-7.7%*

Average annualized total Follower Return in 2015**

* excludes extreme deciles to account for apparent anomalies

** between 2 Jan, 2015 and 31 December, 2015

2015 Activist Insight Index Q1-Q3



Whilst both the Activist Insight Index and two of the major indices fell during the first three quarters of 2015, the former fared better, losing 3.3%, whilst both the MSCI World and S&P 500 Indices were down more than 5% during this period.

The 2015 Q1-Q3 figure is worldwide and based upon 34 funds with a primary focus on activist investing.

The importance of permanent capital

So far, the fallout from these returns has been limited. Pershing Square Capital Management, which returned over 40% in 2014, told investors that this was likely to be its worst year ever. Its publicly listed fund ended 2015 down 21%. Smaller funds have been blown up by less, yet Pershing Square had suffered only $39 million of redemptions at the end of November. A combination of its record for previous market-beating returns, tight redemption options and permanent capital ensure it will go into 2016 in good shape.

Pete Michelsen, who leads the activism defense practice at CamberView Partners, puts this in perspective. “After the financial crisis, structures were put in place to moderate withdrawals and some were able to raise permanent capital,” he says. “Nonetheless, several hedge funds received pressure to return external capital in the past year.”

Fundraising is unlikely to be easy, however. A basket of managers tracked by Cambridge Associates as witnessing slower inflows in 2015: a 5% growth in assets in the first nine months of the year, compared to 12% growth during 2014.

Then there are closures. As reported earlier in the year by Activist Insight, an LA-based activist called Red Mountain Capital Partners is working off its book following a liquidity crunch. LionEye Capital, like Starboard Value a spin-off from asset manager Ramius, closed its doors at the end of 2015 following withdrawals. More may follow, says Veremis. “A broad sell-off could reveal a mismatch between the assets and liabilities of a number of new entrants and smaller funds who have offered generous redemption terms to investors in order to raise more assets.” Forced asset sales, gating of investors and/or the transfer of assets to liquidation vehicles could result from such a mismatch, he adds, although most of the larger activists should be well-protected.

Something to prove

Those funds who have performed poorly in 2015 will be doubly motivated to ensure 2016 is a bumper year, says Michelsen, possibly leading to more aggressive campaigns designed to ensure quick returns. “The last few years saw constructive activism as funds could take more of a ‘wait and see’ approach in a rising or neutral market, but 2016 could see the gloves come off given increased urgency for activists to get back to their high watermarks,” he explains.

Activists like Trian Fund Management and Pershing Square Capital Management do not seem short of ideas, while ValueAct Capital Partners has been forced to sell shares in several core positions to maintain balance in its portfolio following the collapse of Valeant Pharmaceuticals International’s market value. ■

Activist top ten

As is now traditional, Activist Insight ranks activists by the impact they made in the past year on a variety of criteria, including: number of companies where public demands were made; number of new activist investments; average size of targets; and average annualized stock price performance (with dividends included). This year, we've also included the number of news stories we wrote about each fund. JANA Partners and Corvex Management drop out of this year's list, but there is a debut for Land & Buildings, and a new number one.

1 Elliott Management

Companies subjected to public demands	18
Average market-cap of companies subjected to demands ($bn)	7.6
New activist investments disclosed	19
Average annualized total follower return	6.4%
Activist Insight Online news stories	172

It's been a very active year for Elliott Management, the sprawling hedge fund founded by Paul Singer in 1977. The investor set out to force change at 18 companies in 2015, ranging from its traditional technology portfolio to far-flung merger-arbitrage, racking up board seats and strategic reviews along the way. Already, some of those bets look likely to serve the fund nicely—EMC announced the largest ever tech buyout in history in October, American Capital and Cabela's are reviewing strategic alternatives, and board seats at Citrix Systems and Alliance Trust—the UK fund manager where Elliott settled a proxy contest in return for two seats on the board—will hopefully lead to operational improvements in time.

> "In a true shake-out, the careful and successful activists will have plenty to do"

Jesse Cohn, Head of US Equity Activism at the fund, told Activist Insight in a recent interview that the spurt of activity was the result of several factors, including expanding his team's remit from tech to other sectors over recent years and adding staff, the choppiness of equity markets, and interest from other parts of the portfolio. "Being part of a large fund has its advantages—we can share best practices across markets, retain capable local counsel with whom we've had long relationships, and bring in sector and situational experts from other teams to evaluate opportunities," he says. "We're opportunistic in an effort to try to find profitable trades in as many creative ways as we can."

No other activist was as active in 2015, least of all on three continents. And while it is still early to tell whether 2016 is shaping up differently, Cohn is confident that the structures are in place for Elliott to remain one of the most influential activists. Indeed, the fund plans to be more creative, funding buyouts, rolling equity into deals and drawing on expertise from its analysts to highlight opportunities in as-yet unexplored sectors. "Opportunities in debt are starting to look more attractive than they have during the last seven years—we'll see if the market cooperates," he adds.

"If valuations come in there will be a lot of opportunities," Cohn says. And while he doesn't discount the possibility that some managers may be caught out by unpredictable factors in the marketplace, he is certain that activism as a whole will not fall by the wayside. "In a true shake-out, the careful and successful activists will have plenty to do," he concludes.

2 Carl Icahn

Companies subjected to public demands	7
Average market-cap of companies subjected to demands ($bn)	9.7
New activist investments disclosed	8
Average annualized total follower return	19.4%
Activist Insight Online news stories	139

The past year saw Carl Icahn in prolific form, launching at least three thematic campaigns over the course of the year.

The first, in January and February, saw Icahn pressing the likes of Gannett, eBay and Manitowoc to adopt shareholder-friendly governance provisions at their forthcoming spin-offs, including an opt-out from a Delaware law that allows them to prevent hostile takeovers in certain circumstances.

Then, Icahn relaunched his personal website with a video containing a warning of "Danger Ahead" for financial markets from threats such as tax inversion deals, an overheating high-yield bond market and low interest rates, during which he labelled BlackRock "an extremely dangerous company."

Finally, in October, Icahn launched his big activist project for the year, calling for a breakup of insurer American International Group, a project likely to develop quickly when the company announces its plans on 26 January, 2016.

In-between, the veteran activist also had time to buy Pep Boys: Manny, Moe & Jack, in a Christmas bidding war, oust Cheniere CEO Charif Souki and add to stakes in Chesapeake, Freeport-McMoRan and Hertz Global Holdings. Beyond AIG, Xerox may bear the brunt of a new burst of activity from Icahn in the near future.

3 Third Point Partners

Companies subjected to public demands	7
Average market-cap of companies subjected to demands ($bn)	71.6
New activist investments disclosed	29
Average annualized total follower return	-1.0%
Activist Insight Online news stories	64

Dan Loeb's hedge fund had a mostly constructive year, strenuously avoiding proxy fights but making an impact in its Japanese and healthcare investments. In the former, Third Point Partners demanded share repurchases and greater transparency at robot-manufacturer FANUC, getting a surprisingly accepting response. A shakeup of Seven & i Holdings appears slightly more complex, and is an ongoing situation.

Like many others, Third Point continues to hope for greater consolidation in pharmaceuticals. Loeb was at one point reportedly pushing Amgen and Allergan to merge. Now the latter has instead announced plans to merge with Pfizer, efforts to split Amgen may occupy a big chunk of 2016.

Two earlier investments showed greater disparity. Sotheby's showed little sign of a breakthrough in 2015, and has yet to sell its main headquarters in New York, which is expected to be a significant source of value. Dow Chem, by contrast, announced a major deal to merge with DuPont, likely delivering a healthy premium for Loeb's fund.

It remains to be seen whether 2016 will see as much activism from Third Point, given that Loeb recently told investors short positions now outnumbered longs in his fund. Third Point's Offshore fund closed the year down 1.2%.

4 Starboard Value

Companies subjected to public demands	7
Average market-cap of companies subjected to demands ($bn)	7.4
New activist investments disclosed	26
Average annualized total follower return	0.1%
Activist Insight Online news stories	128

After its year-defining proxy contest at Darden Restaurants (and first-place in last year's Activist Top Ten), a series of challenges slowed Starboard Value down in 2015.

Foremost among these was a delay to Yahoo's planned spin-off of its stake in Alibaba due to tougher guidance from the US tax authorities. The company is now proceeding with Starboard's original plan, but has allowed speculation about its future strategy and openness to takeover offers to get out of hand—a spiral Starboard has attempted to halt with ever-clearer indications it will run a proxy contest at the company in 2016.

Elsewhere, the marriage of Staples and Office Depot is on the rocks thanks to a third party: competition regulators at the Federal Trade Commission.

Darden continues to do well, meanwhile, acting on a real estate spin-off sought by the activist. So happy with new CEO Gene Lee are the Starboard team that he has since joined the board of Advance Auto Parts, another Starboard investment.

Wausau Paper, tipped as "one-to-watch" in our last Annual Review, sold itself for just over $500 million during the year, in line with the activist's initial projections. For 2016, expect Starboard to grasp the nettle at Yahoo, and continue working through its book of technology stocks.

5 Trian Fund Management

Companies subjected to public demands	5
Average market-cap of companies subjected to demands ($bn)	60.7
New activist investments disclosed	4
Average annualized total follower return	0.9%
Activist Insight Online news stories	96

2015 was something of a transition year for Trian's portfolio, with the activist trimming positions in Ingersoll-Rand, Legg Mason and Wendy's, and Family Dollar Stores brokering a deal to be acquired by Dollar Tree. New stakes in General Electric, Pentair and Sysco will instead spend much of the new year subjected to Trian's famously forensic research.

The most notable outcome of Trian's activism in 2015, however, was clearly at DuPont. Trian came within a whisker of getting Nelson Peltz elected to the board of directors in May, and in October the company sacked CEO Ellen Kullman despite plaudits earned for her vigorous response to the campaign. Come December, and the specialty chemicals business announced a merger with Dow Chemicals, to be followed by a breakup into three separately-listed divisions. Trian reportedly played a key role in negotiating the deal.

Going into 2016, General Electric and Mondelez will likely be key catalysts for the portfolio, while the progress of Peltz's son Matthew may be something to keep an eye on. Peltz Jnr, a Portfolio Manager and Partner in the firm, joined the board of Wendy's in 2015 and is also an observer to the board of Pentair.

6 ValueAct Capital Partners

Companies subjected to public demands	7
Average market-cap of companies subjected to demands ($bn)	26.0
New activist investments disclosed	8
Average annualized total follower return	2.1%
Activist Insight Online news stories	79

ValueAct's long history championing Mike Pearson's ambitious plans for Valeant made that stock the defining subject of its year. Mason Morfit, who had previously resigned from the board to focus on Microsoft, was recalled and appointed to a three-man committee overseeing the management team when Pearson fell sick at the year-end. Valeant's traumatic second half of the year also meant ValueAct was forced to trim other positions in order to balance its portfolio, overshadowing some of the good news elsewhere.

Microsoft's success likely provided a solid backbone to the fund's returns, however, and other achievements for 2015 included a board seat at MSCI and helping to push the merger of Towers Watson and Willis Group to fruition.

Given Jeff Ubben's comments about the rise of activism crowding out opportunities in recent years, it was hardly surprising to see ValueAct looking elsewhere for value. The activist is currently hoping to secure a board seat at Rolls-Royce Holdings, the troubled British engine manufacturer. A series of profit warnings is likely to help its case, but question marks remain over the company's land and sea division.

Other positions to watch include Twenty-First Century Fox, which may be on the cusp of announcing a new business strategy, and American Express.

7 Land & Buildings

Companies subjected to public demands	5
Average market-cap of companies subjected to demands ($bn)	5.5
New activist investments disclosed	4
Average annualized total follower return	18.3%
Activist Insight Online news stories	60

A debut in the Activist Top Ten, Jonathan Litt's fund had a memorable year topped by the sale of Associated Estates in the midst of a bitter proxy fight. That experience emboldened Land & Buildings, which, as the name suggests, focuses on real-estate investments, to wage further contests at MGM Resorts International, Macerich and American Residential Properties, none of which went to a vote—though the latter has since said it will sell itself and MGM Resorts looks likely to spin-off property into a real estate investment trust (REIT).

According to an investor letter seen by Activist Insight, Land & Buildings finished 2015 up 24.7% after fees and says activist situations have generated a 35% gross return since the second quarter of 2012, when it began to engage with companies more proactively and adopt more concentrated positions.

High on the fund's agenda for 2016 will be New York REIT, where the activist has called for board changes and, like two other activists before it, a strategic review. With the company delaying its annual meeting until October, however, the activist may have to be patient to get what it wants. In the meantime, it has suggested it could run a contest at NorthStar Asset Management, calling for an extension of the nomination deadline.

8 Bulldog Investors

Companies subjected to public demands	11
Average market-cap of companies subjected to demands ($bn)	0.3
New activist investments disclosed	16
Average annualized total follower return	-4.2%
Activist Insight Online news stories	78

Long a devotee to the world of closed-end fund arbitrage, Bulldog Investors ramped up its activity in 2015 with a vengeance. Among its signature demands were the addition of new directors to the boards of targeted funds and liquidation or self-tender programs to close the discount gap.

The activist did venture out of the financial world for a proxy battle at construction services firm Hill International, following its decision to reject a takeover offer from DC Capital Partners. After a testy and litigious campaign, Bulldog won the support of ISS and forced management to scrap its poison pill, but lost the vote. In December, DC Capital reduced its offer for the company from $5.50 per share to $4.75 on the basis of deteriorating financials. Nonetheless, Bulldog continued to support a sale, and has added to its stake.

9 GAMCO Investors

Companies subjected to public demands	8
Average market-cap of companies subjected to demands ($bn)	3.3
New activist investments disclosed	6
Average annualized total follower return	-12.2%
Activist Insight Online news stories	58

GAMCO Investors may have lost its annual contests at Superior Industries International and Telephone & Data Systems, but had a more productive year with other holdings. The activist won three seats on the board of Myers Industries in a vote, and three on the board of Pep Boys: Manny, Moe & Jack in a settlement, five months before management sold the company to Carl Icahn following a bidding war.

Wausau Paper, another GAMCO holding, also sold up in 2015, but the activist has continued to question Journal Media Group's takeover by Gannett, saying real estate value may be squeezed in the deal.

Sevcon, Eastern Company and, unsurprisingly, Superior Industries International are all likely to be on Mario Gabelli's hit list in the first half of 2016.

10 Pershing Square Capital Management

Companies subjected to public demands	5
Average market-cap of companies subjected to demands ($bn)	30.4
New activist investments disclosed	5
Average annualized total follower return	-18.4%
Activist Insight Online news stories	157

Performance-wise, 2015 turned out to be Pershing Square's worst year since its formation in 2004. Nor was the misery confined to a high-profile bet on Valeant Pharmaceuticals that unravelled in the second half of the year. Other platform companies in Pershing Square's portfolio, Platform Speciality Product and Nomad Foods, also suffered, while Herbalife continued to defy the activist's short campaign.

Nonetheless, Bill Ackman's firm seems primed for a busy 2016. It is backing Canadian Pacific Railway to make a hostile takeover bid for Norfolk Southern, and has yet to exert its influence at Mondelez, where its $5.5 billion investment was the largest initial activist bet ever. With the fund looking more or less fully invested, however, some asset sales may be required for Pershing Square to wage new campaigns. ■

2015 in numbers

A global phenomenon

Activism surged in multiple markets during 2015, with the US and Australia enjoying a particularly active year. Activity in Canada and the UK was flatter by comparison, while activists targeted a variety of Asian-based companies (including a number of US-listed Chinese companies facing delisting by their majority owners). The map below shows the number of companies publicly subjected to activist demands in 2015 by HQ-location.*

**Figures exclude activist short positions*

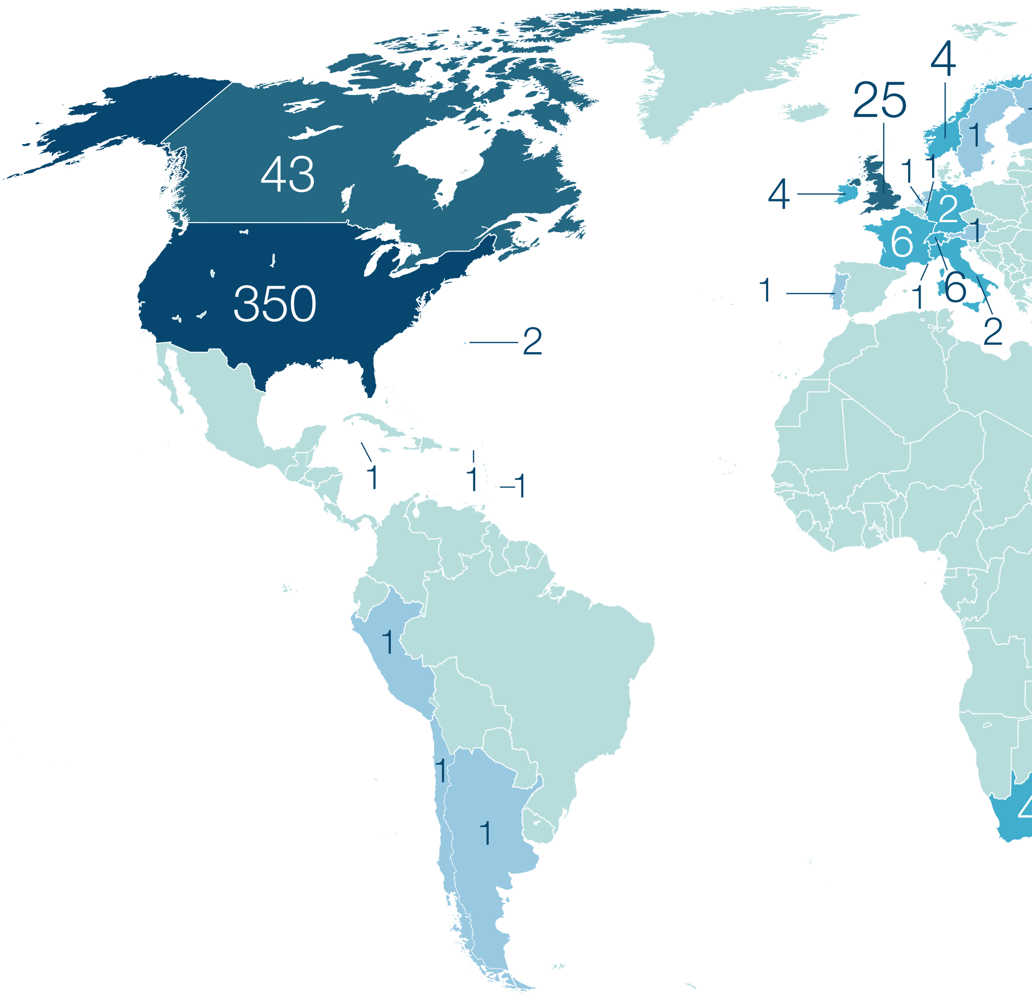
$173bn

Assets managed by funds with a primary focus on activist investing

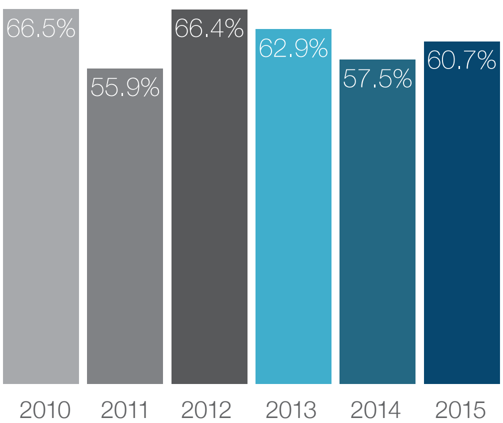
$249.8bn

Total value of worldwide activist-held stocks* as of 19/01/2016

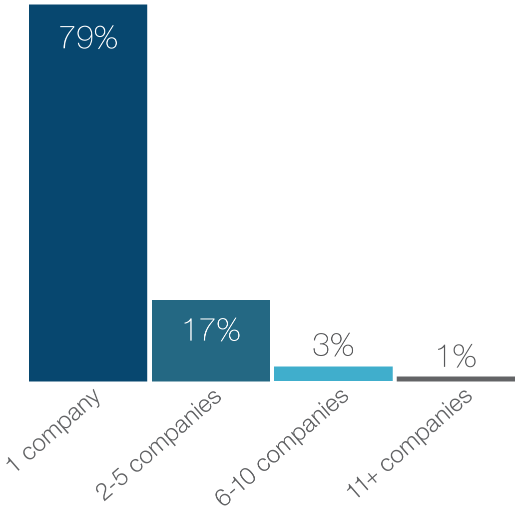
** Long positions only*



Activist success rates

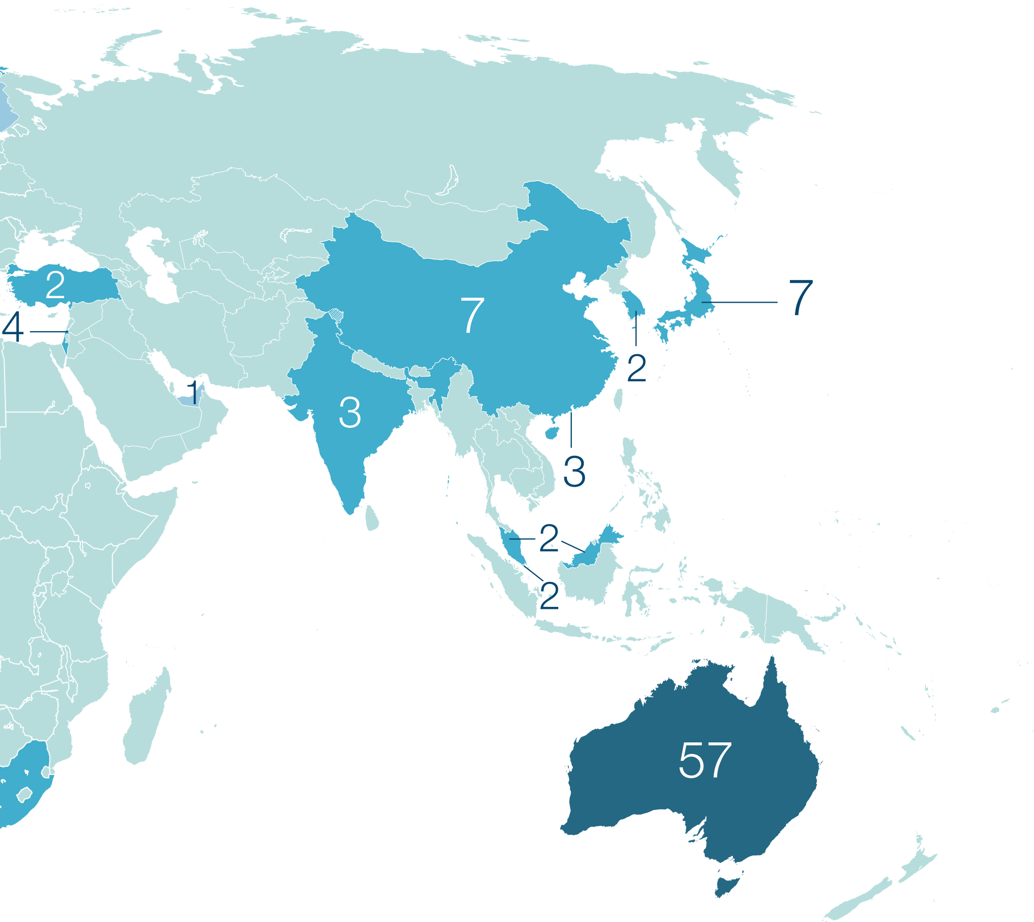


Activists had a mixed year in 2015, with more resolved demands at least partially satisfied in the US than any time since 2010, but traction elsewhere notably harder to achieve. In Europe, the rate was just 54%, although the UK was significantly above the average. Asian companies yielded at least somewhat to activist demands 47% of the time, above the average for the past six years.



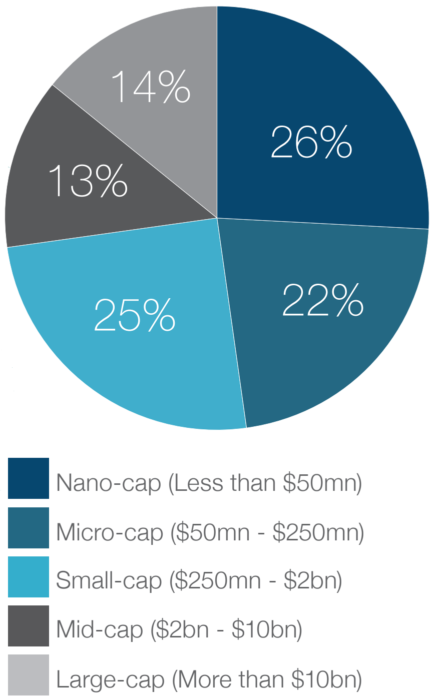
Number of companies targeted per activist

While a small cohort of full-time activists hog the spotlight with their increasingly complex demands, the vast majority of investors made public demands at just one company in 2015, highlighting the sheer number of active activists.

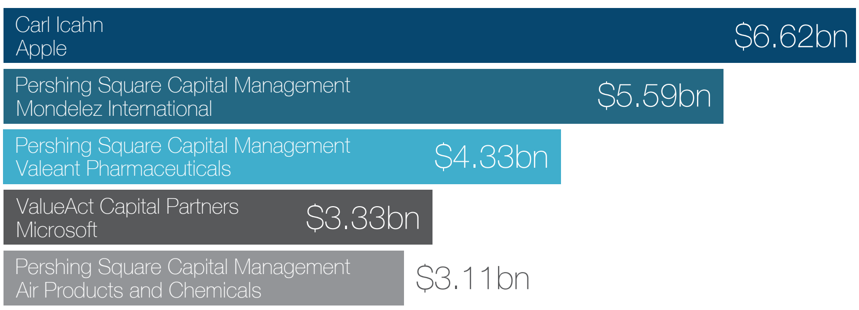


Activist targets by market-cap

Activists made more demands in the $250 million to $10 billion category than in previous years, a result both of slightly fewer large companies being targeted and a more significant drop in micro- and nano-cap activism as investors had more capital to deploy.



2015's largest activist investments



The largest stakes held by activists at their 2015 peak, measured by the date of Schedule 13D or 13F disclosure.

62

companies in the S&P 500 Index were publicly subjected to activist demands in 2015

Schulte Roth & Zabel

WWW.SRZ.COM

A bit more welcome

An interview with Marc Weingarten, Eleazer Klein and Jim McNally of Schulte Roth & Zabel.

Activism has grown again in 2015. Why are more companies being targeted than ever before?

Eleazer Klein: There are a number of reasons. First, the space is still of high interest. The amount of money invested in funds targeting and participating in various forms of activism continues to grow, at least for now, as investors look for ways to generate returns. Second, while there might be less low-hanging fruit now, there are still underperforming companies, and with the recent volatility, more companies will be falling behind. And third, investors who in the past would have been angry about their investment in a company and done nothing, are now looking at their options more carefully.

Marc Weingarten: It's true that the established players had more capital and people are trying activism for the first time. Some multi-strategy funds are adding activism to their portfolios, while others will only ever be occasional activists.

Jim McNally: We've seen this in Europe too, with a few managers dipping their toes into activism with a view to launching a more dedicated product in the future.

Wasn't the outcome of the DuPont proxy fight supposed to halt activism in its tracks?

MW: More was made of it than probably should have been. The odds were stacked against Trian—an iconic company with a huge retail investor base and decent performance—and still DuPont just barely won. And since then, there's been a change to the CEO and a major merger.

> "DuPont is really the poster-child for what activism can achieve whether you win or lose the vote"

EK: And DuPont didn't just sit still and win—they actively made many of the changes Trian was pushing for even during the contest. It's really the poster-child for what activism can achieve whether you win or lose the vote.

Could regulatory changes that some critics of activists are pushing for really slow the pace of activism?

EK: Everything has an effect, but I don't see anything on the horizon having a major one. More proactive enforcement of anti-competition rules could lead to a decline in some M&A, but I don't think it will have a lasting impact. Universal ballots could change things.

MW: There has been long-standing criticism of the Schedule 13D filing rules, but if there was a shorter deadline to file after accumulating 5% of a company's stock or a lower threshold I don't think it would stop activism in its tracks. It's not that common for activists to load up on the stock in the ten-day window—in fact, it's done very occasionally. And activists have routinely been successful at ownership levels below the 5% threshold.

We've seen some situations in 2015 where activists and CEOs have flaunted their relationships. Do you think activists are more welcome in the boardroom?

EK: "Welcome" is too strong a word. At the margins, there has been some recognition that activists can add value in the boardroom. But most boards still really aren't happy about shareholders "meddling" in corporate management. So there are the beginnings of a change, and maybe that will pick up in the coming years.

There has been talk of activists being less than happy with the settlement agreements they've entered into and considering a second nomination in order to get things moving. Is that a trend you've seen?

EK: It's a fascinating point. There is a feeling among some activists that maybe the activist winds have shifted too fast, too quickly, and several of our clients are thinking of second bites at the apple. It's too early to say whether it will lead to a breakout of new proxy contests, however.

“‘Welcome’ is too strong a word. At the margins, there has been some recognition that activists can add value in the boardroom”

Marc Weingarten, New York-based Schulte Roth & Zabel Partner and Co-Chair of its global Shareholder Activism Group

Eleazer Klein, New York-based Schulte Roth & Zabel Partner and Co-Chair of its global Shareholder Activism Group

Jim McNally, London-based Schulte Roth & Zabel Partner and member of its global Shareholder Activism Group

What is the most egregious entrenchment device you have seen this year?

MW: The advance notice bylaw at EPIQ Systems is one of the worst entrenchment devices I’ve ever seen. It’s a fundamental feature of corporate law that any shareholder has the right to nominate a director, but this company has sought to restrict that right only to investors who have held over 5% of the stock for more than two years, as well as putting the notice deadline seven months before the annual meeting, and requiring all communications between the proponent and its nominees and other 5% shareholders to be disclosed. SRZ filed suit in Missouri, where the company is incorporated, over that one.

Jim, what developments have there been in Europe over the past year?

JM: The level of activity has been fairly steady. Like in the US, boards are often more willing to deal with activists, so that particular route is perhaps a little bit more open. That said, the conversations are not getting any easier, especially with underperforming companies where management may have a reason to hide. Boards are also getting better prepared in their interactions with activists—which can of course be a benefit for both camps.

Institutional investors are ready to assess activists on a case-by-case basis, and there is certainly some caution here in terms of whether they will lend support to any given campaign, be that support public or behind closed doors. The institutions are keen to make sure they support the right type of activist. As a result, activists in Europe have to show they understand, and are willing to play by the rules.

What can we expect to see in 2016?

EK: I think we can expect to see more settlements and bigger companies being targeted. We might see more in the energy sector if investors feel that the market has bottomed-out and there are situations they can fix. Of course, lots of companies are underperforming because of the market, but there will be other situations where there are opportunities.

Another potential trend we will see more of in 2016 is debt-based activism, not so much for the traditional activists, but for newcomers and specialists. It’s easier to protect downside with debt rather than equity, and the debt really controls distressed companies.

MW: I think we may see more activists push for M&A. Historically, there has been a drive for spin-offs to create pure plays in various industries. Where those have taken place, I think you may see activists try to link up similar companies. Issuers with significant net operating losses can also be a vehicle for platform strategies.

JM: There’s a similar feeling in the United Kingdom. Activists are now more willing to pursue more complicated strategies, including merger opportunities, and we have seen some of that here in London. I’m not sure how common that will be, or how public (though eventually some of it will of course have to be), but it is certainly happening.

MW: Another trend that will continue is the launch of activist funds that specialize in a specific sector. We already have activists that focus on banks, mutual funds, real estate and pharmaceuticals, and we’re working on the launch of several new funds with a single industry focus. ■

Getting shorty

When the markets turn, short-sellers often get the blame. Yet with activist short-selling on the rise, investors can't always say they weren't warned.

If 2015 was a difficult year to be an activist investor, it was a hoot to be in the activist short-selling game. According to Activist Insight's Follower Returns analysis, US stocks targeted by activist short-sellers returned an average annualized 24% to those betting against their continued rise, even after the dividends they were required to pay the shares' owners were taken into account (extreme deciles excluded).

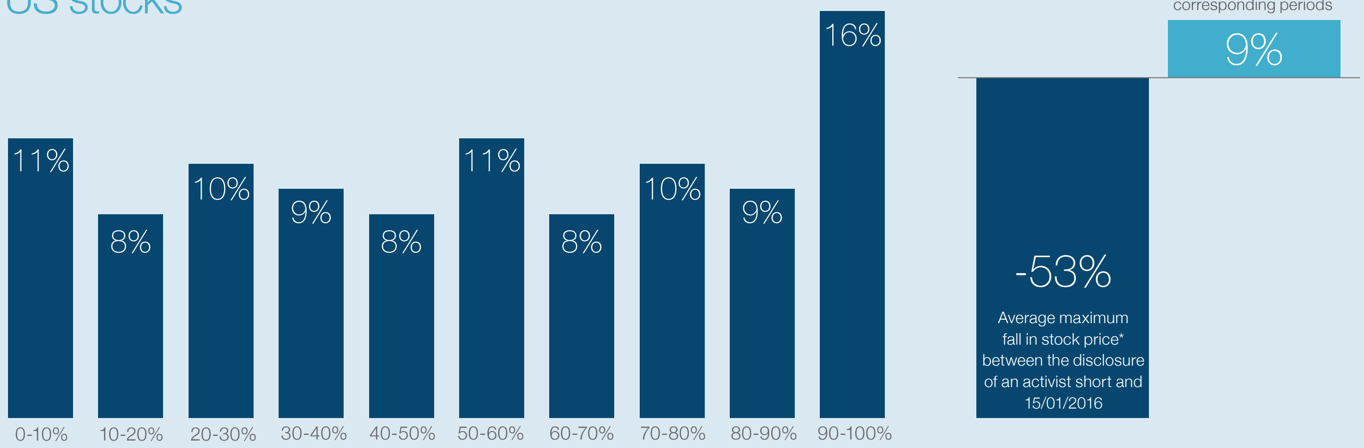
Activist short-sellers have a decent record. More than half of stocks subjected to activist short-selling attacks since 2010 fell by a maximum of more than 50% after a report was published, with the average maximum fall 53%, and a quarter falling more than 80%.

Activist short-sellers are on the rise, targeting 143 companies in 2015, compared to 105 the previous year. Carson Block, founder of activist short-seller Muddy Waters Research, told Activist Insight in a recent interview that the pendulum had swung his way after a bullish seven years for equities. "Our own feeling is that conditions have been pretty good for short-sellers because valuations are stretched, there's a lot of debt on balance sheets, there are a number of companies employing aggressive accounting, and investors seemed to be worried about the markets," he said.

Tech stocks bore the brunt of the attacks in 2015, accounting for 41 of the targeted companies. The next biggest category, healthcare, attracted interest from the likes of Kerrisdale Capital, which took on Bavarian Nordic after deeming its prostate-cancer vaccine, Prostvac-VF, "ineffective." Perhaps surprisingly, basic materials stocks represented less than a tenth of those targeted. But then, you didn't need a short-seller to tell you commodity-reliant industries were going to get crushed in a year when prices were under intense pressure.

Continued turmoil early in 2016 suggests short-sellers will again be out in force, and Block believes companies which have predicated their success on aggressive accounting make obvious targets. "Aggressive accounting matters more to investors when there's debt to service," he says. "Given the build-up in debt on balance sheets—particularly for questionable M&A and share buybacks—companies with aggressive accounting will likely be fertile ground for short sellers this year." ■

Maximum share price fall* of activist short targeted US stocks



**Between short disclosure and 15/01/2016, excluding investments with a duration of less than two months*

Ready for action

An article by Andrew Honnor, founder and managing partner of Greenbrook.

The size of his in-tray may have seemed daunting enough when Dave Lewis slipped into the hot seat at Tesco, Britain's biggest grocer; turning round falling sales and whipping the business into shape would be tough enough for any chief executive, let alone a newcomer to the supermarket world. So, when Bill Ackman, founder of Pershing Square, a leading American activist fund, revealed a year ago that he had actively considered taking a stake in Tesco, it might have seemed like another giant headache.

As it turned out, Ackman cooled on the idea of getting involved in the uber-competitive British food retailing scene, but it didn't stop the markets acting with huge excitement at the prospect. The shares forged ahead and the press lapped it up.

It is not hard to see why. The British media, in particular, loves a confrontation and Ackman, hardly a wallflower when it comes to offering his take on where management teams might be going wrong, delivers great copy. The idea of him duking it out with Tesco was irresistible. It would have been the same had it been Carl Icahn or Daniel Loeb; the names matter little, it is all about the fighting.

While the media may see these situations as good, knockabout stuff, they can represent a challenge from a communications perspective. Brits may enjoy the spectacle of sometimes stolid and unimaginative management teams being given a good rousting—look at the glee with which Alliance Trust's bruising encounter with Elliott was greeted—but to garner the support of most other stakeholders, activist campaigns need to be carefully planned and co-ordinated.

> “A public campaign requires a well- thought-out approach with a set of key messages that have been carefully crafted for a variety of audiences”

Fellow shareholders, politicians, regulators and staff all need to be sure of an activist investor's intentions and reassured that funds agitating for change are not simply doing it to make a quick buck; that the kind of shake-up they are calling for is in the best interests of all stakeholders. If you want to win, it is vital to have all the relevant interested parties aligned and it is important to have others advocating on your behalf. One of the reasons Elliott proved successful at Alliance Trust was because many accepted the Americans' fundamental thesis that the business had become stale. Change was needed.

Conversely, much head-scratching greeted the arrival of US activist Marcato on the share register of Intercontinental Hotels Group. With little explanation, it called for a sale or merger of the FTSE 100 leisure operator, one of the most successful businesses in its sector that has kept investors sated by returning billions of pounds.

None of this is to say that institutions in Europe don't want to see improvement in the companies they back. But publicly carping from the sidelines is not necessarily the best way to achieve results. In Europe, traditional long-only institutions much prefer to agitate for change behind closed doors, making their feelings known in private rather than out in the open. It is an approach that has frequently proved effective, with several high profile chief executives, for example, falling on their swords after being read the riot act in private.

A public campaign requires a well-thought-out approach with a set of key messages that have been carefully crafted for a variety of audiences. It is essential that before embarking on what may be a lengthy campaign, activist investors gauge the mood of the market and seek to engage with as many stakeholders as possible if they are to ensure success. ■

Greenbrook is a London-based financial communications company, which specializes in representing investment companies.

+44 20 7952 2000 | greenbrookpr.com

Get me to the vote

An analysis of US proxy contests shows activists are asking for more and getting less when it comes to board seats.

In many ways, 2015 was far less concerned with proxy contests than previous years. Aside from Trian Fund Management's efforts at DuPont, the list of names which launched a proxy battle were as notable for the absentees—no Icahn, Pershing Square or JANA Partners, for instance—while nominations by the likes of Starboard Value and Third Point Partners were quickly and quietly settled.

Board seats have not suddenly fallen out of fashion, of course. According to Activist Insight data, activists sought board seats at 157 companies in 2015, 81 of which were settled convivially, and 76 involving at least a show of resistance from the company. Those numbers were all up on 2014, when board seats were sought at 120 companies.

Proxy contests, however, are more than ever the exception to the rule. Only 23 went to a vote in 2015, up only slightly on 2014 and a considerably lower proportion of the total contested situations at 30% than the year before, when 35% of contested situations went to a vote. That is likely a reflection of activists' success in previous years, as well as their clear preference for avoiding a public spat on their side, as much as on the issuers'. "Activism, as far as its tactics are concerned, has seen a trend towards longer holding periods and more constructive, behind-the-scenes engagement," says Steven Balet, a Managing Director at FTI Consulting. "This is likely to continue, although in some cases driven by M&A, activists' campaigns could be more event-driven and urgent in nature."

Those proxy contests that were waged in 2015 were scrappier and less lucrative affairs for activists than in previous years, however, perhaps reflecting the flood of new entrants to the space. Activists gained 184 board seats in 2015, compared to 213 the year previously. Indeed, in contested situations that went to a vote, activists triumphed in two of every three situations in 2014; last year, the proportion was less than one in two.

The trend is also clear from the number of board seats activists are winning. In contentious situations—where an activist has stated its desire to seek board seats and management has shown resistance—activists asked for an average of 3.4 board seats and received an average of 1.2. The previous year, the average was 2.3. In campaigns that did not develop into a public disagreement, activists averaged 1.1 board seats from 81 companies in 2015, compared to 1.4 from 65 companies in 2014.

As well as new entrants, the kinds of opportunities open to activists may be dwindling. Last year saw several contests at unpromising companies, including those with dual class share structures (Casella Waste Systems) large insider holdings (Ethan Allen Interiors) and large retail components to the shareholder base (DuPont).

Many CEOs will remain determined to avoid proxy contests in 2016, not least AIG's Peter Hancock and Yahoo's Marissa Mayer. The same will probably be true for activists, lest they find that their magic is wearing just the tiniest bit thin. ■

US Proxy contest statistics

	2014	2015
Companies where activists sought board seats	120	157
Settlements	102	112
Proxy contests that went to a vote	19	23
Board seats gained	213	184
Average board seats gained per contest	2.3	1.2
Success rate in contests that went to a vote (at least one board seat gained)	68%	48%

“Those proxy contests that were waged in 2015 were a scrappier and less lucrative affair for activists than in previous years”

Proxy contest case studies

Activist	Trian Fund Management
Company	DuPont
Size of dissident slate	4
Number of management nominees	12
Number of dissidents elected	0
Average vote for (% vote in favour of each nominee)	30.8%
Significant backers	Fidelity, T.Rowe Price
Significant opposition	BlackRock, Vanguard

Activist	Sandell Asset Management
Company	Ethan Allen Interiors
Size of dissident slate	6
Number of management nominees	7
Number of dissidents elected	0
Average vote for (% vote in favour of each nominee)	23.6%
Significant backers	AllianceBernstein, CalSTRS
Significant opposition	BlackRock, CalPERS

Activist	Barington Capital
Company	Eastern Co
Size of dissident slate	2
Number of management nominees	2
Number of dissidents elected	2
Average vote for (% vote in favour of each nominee)	62.2%
Significant backers	GAMCO, Vanguard
Significant opposition	Geode, Northern Trust

Activist	Marathon Partners
Company	Shutterfly
Size of dissident slate	3
Number of management nominees	3
Number of dissidents elected	2
Average vote for (% vote in favour of each nominee)	49.9%
Significant backers	Dimensional, Northern Trust
Significant opposition	Vanguard, State Street

Source: Activist Insight Online & Proxy Insight

Proxy litigation spotlight

An interview with Michael Swartz, Schulte Roth & Zabel Partner advising on shareholder activism litigation handled by the firm.

Most proxy contests settle pretty quickly these days. How much litigation is going on behind the scenes?

It’s not uncommon for a company to raise issues about a nomination’s compliance with the company’s bylaws. Better-run companies tend to be more reasonable about interpreting their bylaws to allow shareholder proposals to go forward and allowing activists to correct any technical deficiencies, but some situations do require litigation. We see “scorched earth” battles principally where a company is concerned about losing the proxy contest and decides that its best defense is to keep the activist off the ballot or to try to bleed the activist into a favorable settlement by running-up litigation costs, which usually get reimbursed as part of the settlement. In addition, litigation can be an option when a company seeks to delay or adjourn its annual meeting.

What are the most common issues you find yourself litigating?

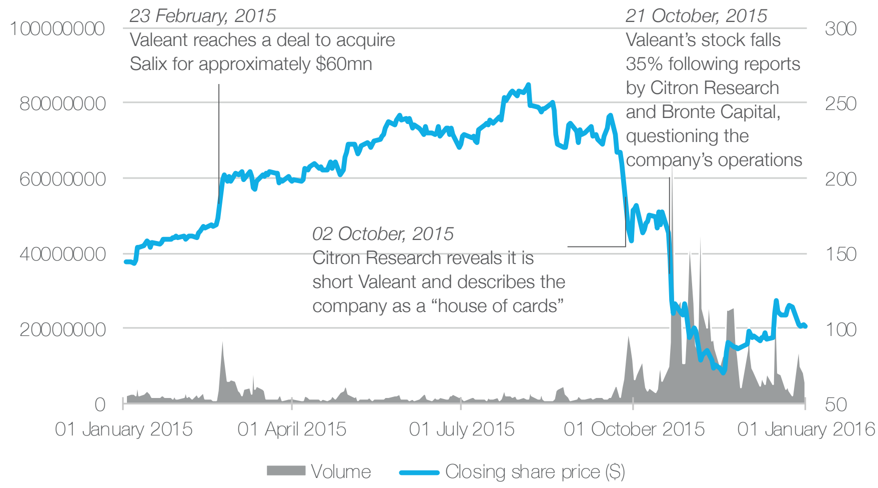
Recently, we’ve litigated cases having to do with shareholders’ compliance with companies’ advanced notification bylaws, including eligibility and disclosure requirements for nominations. Another common issue is for companies to allege Section 13D violations—arguing that an activist has failed either to disclose a group agreement with another shareholder or changes to its plans or proposals for the company—and seeking sterilization of the activist’s shares so that they cannot be voted at the annual shareholders meeting. Those actions don’t usually succeed in defeating an activist threat—”corrective” disclosures are nearly always deemed by the courts to be an adequate remedy. Companies also can use the discovery stages of litigation to dig for information they will then use in their solicitation materials.

Campaigns of 2015

Choosing campaigns that highlight some of the most significant moments in activist investing over the past year is, in many ways, a thankless task. Each of the 551 was unique in its own way. That's why we've chosen to recap some of the most written about campaigns, three from outside the US, and two which pitted long investors against shorts. More detail, including activist quotes, timelines and stock price performance is available on Activist Insight Online.

Activist Insight was pleased to have expanded its journalism team in 2015, with an obvious impact. As well as producing the magazine Activism Monthly Premium each month, we frequently publish between 25-30 stories on each daily news summary. These are the companies that earned the most column inches from the team last year.

Valeant Pharmaceuticals International



It's hardly surprising that Valeant Pharmaceuticals International was our most written-about stock of 2015. By the end of the year, our journalists had published more than 80 separate articles on the company Bill Ackman put at the center of his Sohn Conference presentation in May. A quick glance at the company's share price chart indicates why interest in Valeant has been so high over the past year. At the time of Ackman's speech, Valeant had returned more than 45-times its market value between Mike Pearson's appointment as CEO in 2008 and May 2015, from a strategy of acquiring smaller rivals, stripping out costs and increasing prices. According to Ackman, it made an average 20% return on acquisitions, rising to 30% with tax synergies.

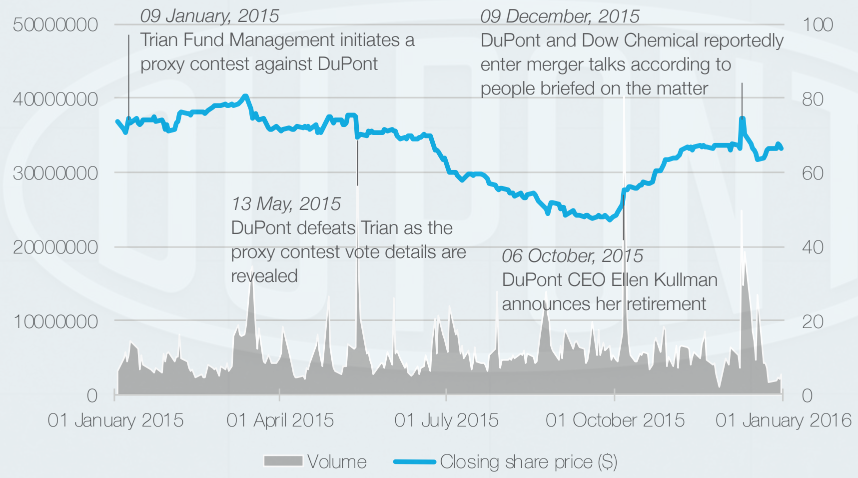
Ackman's influence on Wall Street gave the impression that his fund's support could be the catalyst to greater things for Valeant. The Quebec-based drugmaker had earned dramatically more attention in 2014 by partnering with Pershing Square to attempt a hostile takeover of Allergan, and when it missed out on that prize, it quickly secured a deal for Salix Pharmaceuticals. Pershing Square contributed around one-third of the new equity raised by Valeant for that deal.

As events highlighted, however, it was not Valeant tying its fortunes to Pershing Square, but the other way around. In addition to Congressional interest in "price gouging"—raising the prices of newly acquired product lines—short-sellers weighed down on the company's accounting practices and investigative reporters began to look into a specialty pharmacy used by the company as a middleman. Valeant's protestations that the pharmacies in general represented only 7% of Valeant's income in 2015 and had not led to double-counting of sales failed to convince the market and earned a rebuke from Ackman himself, though the activist also bought a further two million shares to show that he believed the mistakes were a mere miscommunication.

Ackman was far from the only investor stung by the fall in Valeant's stock, which ended the year 30% lower than at the beginning of the year, but lost 70% from its August peak to November trough. ValueAct Capital Partners was forced to trim other positions to rebalance its portfolio, while the management team behind Sequoia Fund is being sued for allowing the stock to grow to almost a third of its portfolio.

How Valeant will fare in 2016 is far from clear. Pershing Square is bullish, increasing its exposure through options, while ValueAct's Mason Morfit returned to the board to oversee the cleanup, in addition to the board seat the fund already held. Many of the catalysts investors previously looked to are less certain, however, with CEO Mike Pearson hospitalized by pneumonia and the company's ability to strike deals uncertain. Thus far, investors have only sent the stock lower.

DuPont

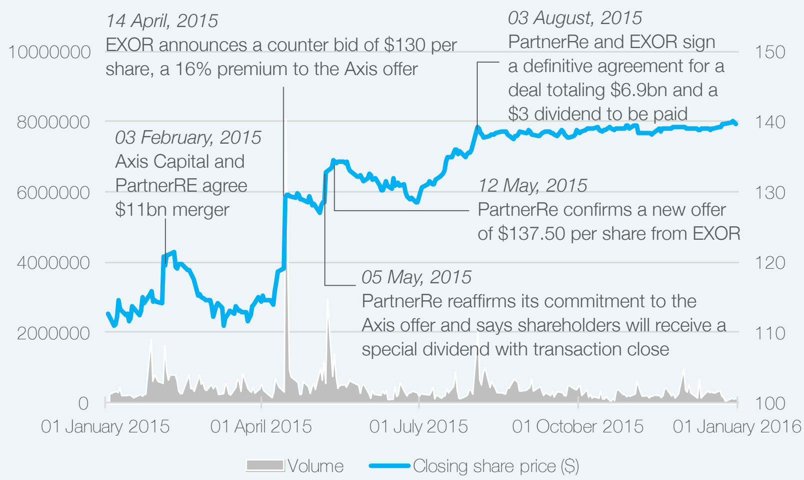


Any one of DuPont's three largest investors could have changed the course of a proxy contest launched by Trian Fund Management had they voted for the activist's nominee, Nelson Peltz. As it was, shareholders gave their support to the board following a spate of changes both to personnel and strategy, but also put them on notice by awarding 43% of the votes to Peltz, the best-supported candidate on a four-man slate. Thus, when confronted by worsening guidance later in the year, CEO Ellen Kullman was given the shove and replaced with breakup artist Ed Breen, whom Trian had wanted for its own slate, making possible a tie-up with Dow Chemical.

Chief among the lessons of DuPont was a reminder that activists frequently achieve significant change without a vote. In this instance, DuPont acted to shore up its shareholder base by making proactive changes, several of which contributed to Trian's analysis ultimately prevailing. Another point of interest was the continuing divergence of the California pension funds in their views on activism. While the California State Teachers' Retirement System (CalSTRS), was a co-filer with Trian in its solicitation, the larger California Public Employee's Retirement System (CalPERS) said it would vote with management.

PartnerRE

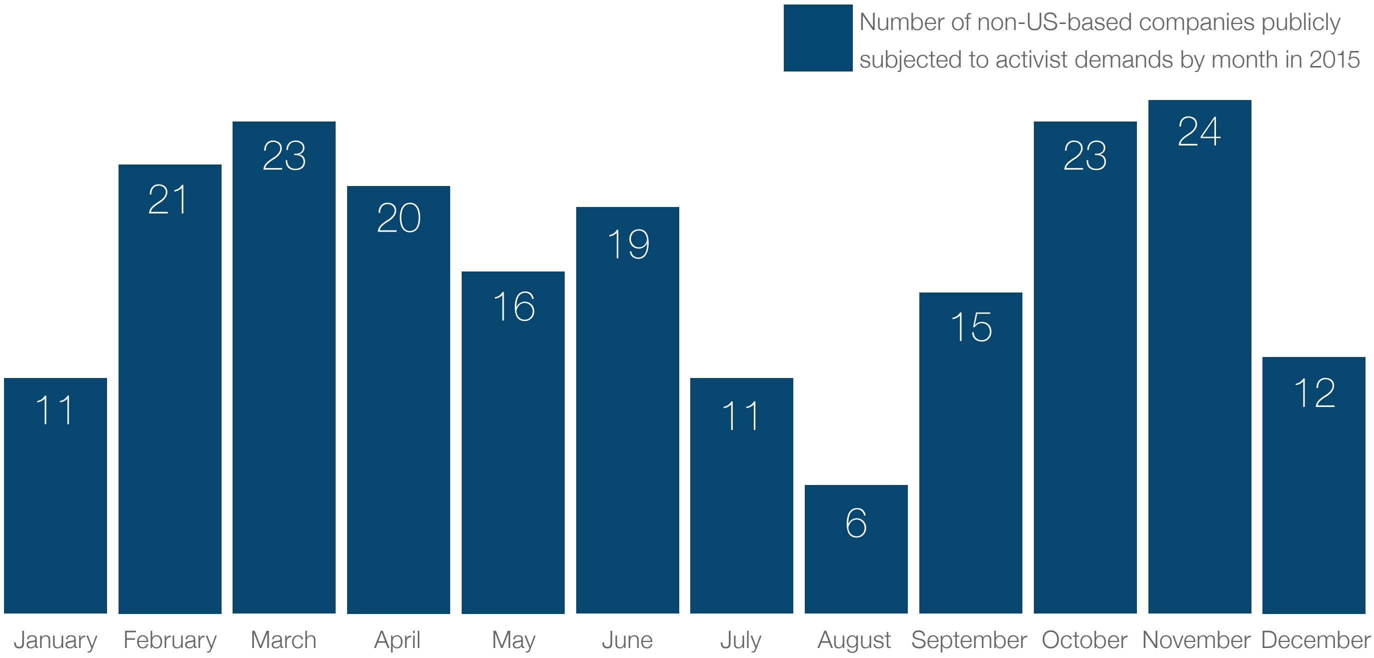
The merger agreement between Bermuda-based reinsurer PartnerRE and Axis Capital Holding was already three months old when EXOR, the holding company used by Italy's Agnelli family, put in a bid. Markets leapt at the prospect of a takeover battle worth hundreds of millions of dollars, and activist investor Sandell Asset Management began protesting that management was unwilling to designate Axis' offer as "reasonably likely to result in a 'Superior Proposal'," saying in a public letter released on 22 May that the recalcitrance raised significant questions about the board's commitment to a fair process.



Over the course of the summer, EXOR fought a model takeover battle, raising questions about Axis' corporate culture, leaning hard on the proxy voting advisers and sweetening its offer with a special dividend that took the price it was willing to pay $13 per share higher than its rival—providing a nearly 10% additional premium for investors in the process. Sandell's role in the process may have been limited to agitating for best practice, but it raised the stakes for management and highlighted a growing preference for cash on the table, as opposed to long-term projected synergies among shareholders.

Non-US situations

With more than two hundred non-US companies publicly subjected to activist demands in 2015, the global spread of activism continued apace. Activist Insight data shows this activity spread throughout the year, with peaks during the Northern Hemisphere proxy season in the spring and the Australian proxy season later in the year.

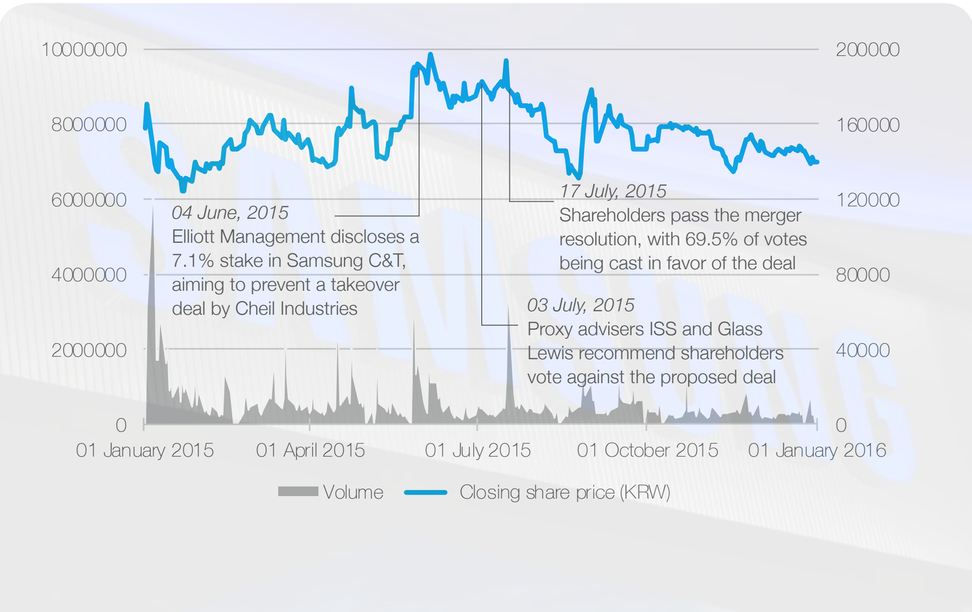


Samsung C&T

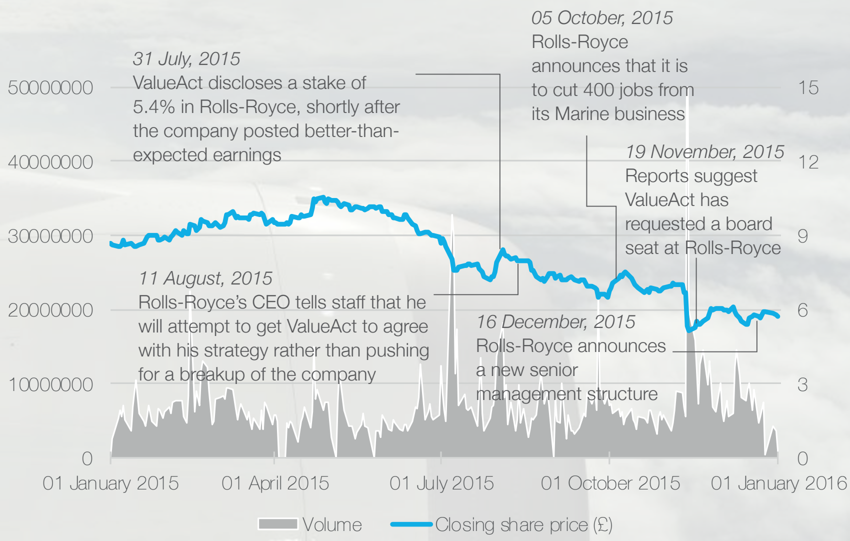
Foreign shareholders in Samsung C&T voted overwhelmingly against the construction company's merger with Cheil Industries in July, following a campaign to block the deal by Elliott Management. Indeed, it was only thanks to the support of the country's National Pension Service that the deal—necessary to consolidate the family empire and avoid hefty inheritance taxes before patriarch Lee Kun-hee's inevitable passing—went ahead. Yet despite the NPS having a voting record that would make even the toughest US pension fund proud, it sided with a proposal many thought undervalued the company.

Elliott, a 7% shareholder in C&T, did not merely resort to a regular proxy solicitation in an attempt to hold management to account. Instead, when the company sold treasury shares equivalent to a 5.8% stake to another group company, the activist contested the deal through the courts. In the end, just under 70% of shares were voted in favor of the deal, comfortably above the two-thirds majority required, but a margin of victory less than the value of those treasury shares.

In a sign of how Elliott's intervention had polarized views on activism in South Korea, the country's sovereign wealth fund—itself an investor in Elliott's fund—reportedly requested the activist no longer invest in the country following the row.



Rolls-Royce



ValueAct Capital Partners keeps a lower profile than some activists, having fought just one proxy contest in its history. Last year, a few harsh words were enough to get a seat on the board of MSCI, and six months into an investment in Rolls-Royce Holdings, the "regular contact" between the activist and the British engine-maker has so far been along familiar lines. That ValueAct has requested a board seat is an open secret, but the core of its thesis remains unclear even as CEO Warren East presses ahead with a restructuring plan of his own.

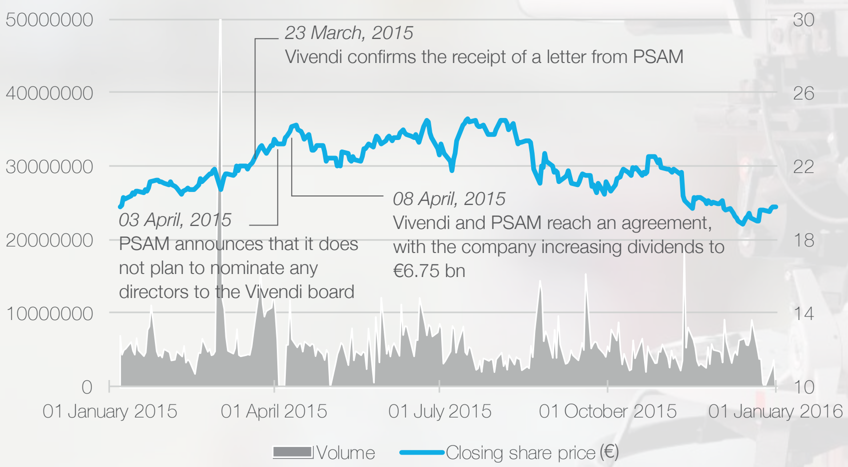
East likes to talk of the fund's thoughts as being "pretty much completely aligned" with his own, but after four profit warnings in little more than a year, there is no certainty that what he has announced thus far will prove sufficient to improve the engineering company's gloomy short-term prospects. Cost savings of £150-200 million will take at least another year to materialize.

ValueAct has at least shown it is committed. After disclosing a 5.4% stake at the end of July, it almost doubled its bet on the company later in the year as shares plummeted. After many false starts, Rolls-Royce has little choice but to press on in 2016—whether it does that with ValueAct on board remains to be seen.

Vivendi

Early in 2015 it seemed possible Vivendi would herald a new trend in European activism after US investor P. Schoenfeld Asset Management (PSAM) demanded the French media conglomerate sell one of its divisions to fund share repurchases. PSAM was even rumored to be lining up an alternative slate ready for the company's annual meeting, although this failed to materialize.

Instead, the campaign ended up highlighting how inhospitable Europe can be for activist investors. Within weeks, the company's Chairman, Vincent Bolloré, had ruled out changes and boosted his own stake and an employee shareholder group had written to protest PSAM's demands. Over the summer, dual voting rights were introduced under France's Florange Law, giving shareholders with a long history in the stock more clout.



Going into 2016, Vivendi's prospects seem finely balanced. Analysts at UBS say the stock is facing "profound and rapid changes" in both its television unit Canal+ and Universal Music Group (which PSAM wanted rid of), leading to volatile performance. And although the company promised to repurchase shares if the stock fell below €20, the analysts worry the company may be slow to react, causing some pain. With shares down 4.5% during 2015 and the company focused on an intervention in Telecom Italia (where it recently won four seats on the board), 2016 could be a make-or-break year for Bolloré's Vivendi.

Long vs. short

When Rob Kindler, Head of M&A at investment bank Morgan Stanley appeared on CNBC recently, he cast scorn on activist investors. Short of targets after a busy three years, he argued their investments were now becoming more far-fetched. "Activism generally as an asset class… I absolutely think it has peaked and I would short the class entirely," he added.

Some investors may be thinking the same thing. According to Activist Insight data, 29 companies that were the subject to demands in 2015 were also targeted by activist short-sellers, including the likes of Yum! Brands and American Capital. Many more investors may be nursing passive short positions, which do not generally need to be disclosed. In this section of our campaign review, we look at two situations in particular that have generated opposing views from both the long and the short community.

"Auction house Sotheby's is at a challenging juncture"

Highest in profile was Cheniere Energy, a duel between heavyweights Carl Icahn and Jim Chanos. Chanos has expressed skepticism that demand for liquefied natural gas (LNG) can continue to grow, or that the company's current clients will be willing to stay locked into expensive, long-term contracts when the price of oil is at rock bottom. With $16 billion of long-term debt and around $130 million of quarterly expenditures at the end of the third quarter, Cheniere does indeed look an ambitious bet. Icahn, for his part, has been investing heavily in the commodities sector over the past year, and has overseen a big shift at the company since August, whose founder and then-CEO, Charif Souki, welcomed the activist's investment and two representatives onto his board.

In December, Souki was relieved of his position, while Icahn has boosted his stake to 13.8%. New Chairman Andrea Botta talks of a transition to "an operating company with stable and growing positive cash flow," eschewing Souki's more ambitious plans. Neal Shear, who took over as interim-CEO, comes from an investment banking and asset management background, suggesting shareholder value will be paramount.

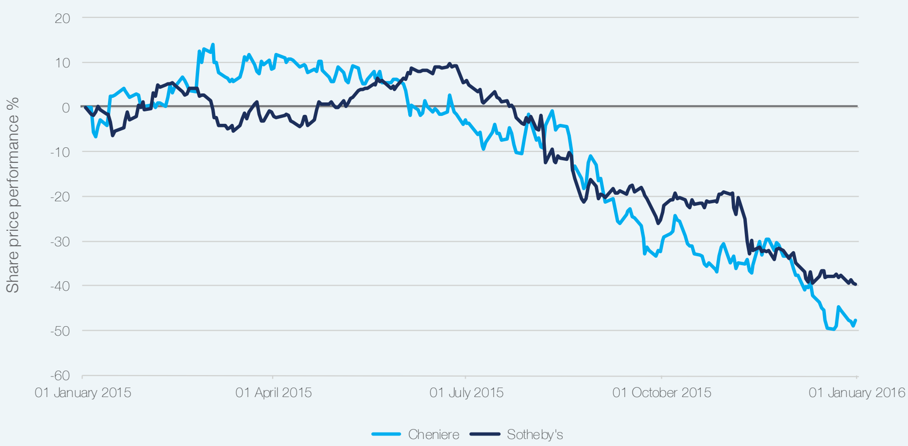
Yet so far it is Chanos who is on the right side of the wager. Shares have fallen more than 40% since he disclosed his short position, while Icahn is down more than 50% since he disclosed his position. With exports set to start in the first quarter of 2016, we may know soon whether Chanos and the doubters are right.

Another stock caught between bears and bulls is auction house Sotheby's, the target of a 2014 proxy contest by Third Point Partners, and a major investment by Marcato Capital Management. Again, Chanos is on the short side, poking fun at the art market's perpetual bubbles and Sotheby's weakness versus traditional rival Christie's and non-traditional online competitors.

George Sutton, who covers the stock for the Craig Hallum Capital Group, admits Sotheby's is at "a challenging juncture," despite backing Loeb to create value the year before. Less consistent demand and competitive threats are risk factors, he wrote in a recent note, though the sale of the company's New York real estate might finally take place in 2016.

Both long activists are likely underwater in the stock, while if Chanos has avoided covering his short he will be sitting on a neat little profit since pitching the bet in London in November 2014. Shares are down 41% since that date—their lowest point since 2009. It may take more than the New York real estate market to bring the hammer down on this campaign. ■

Cheniere & Sotheby's in 2015



Activist Insight

Platform for value

Activists took a long, hard look at platform companies in 2015, but by the end of the year, the value of this model was in serious doubt.

It has been nine months since Pershing Square's Bill Ackman made the case for platform companies at the Sohn Conference in New York, opening a debate on this strategic model within the activism world. In particular, Ackman praised Valeant Pharmaceuticals International, which at the time had increased its stock price by a multiple of 45 in seven years. Platforms, once known as roll-ups, grow through the acquisition and integration of other companies. As Ackman put it in his presentation, in these companies "capital allocation and acquisitions are a core competency and significant focus of senior management and the board."

Once mastered, this competency seems to pay off. Serial dealmaker Martin Franklin has seen the value of shares in the platform companies he co-founded rise dramatically over recent years. Jarden, his first creation, had increased its market value by 47-times at the time of Ackman's presentation. Platform Specialty Products and Nomad Foods—founded by Franklin in 2013 and 2014 respectively—were at that point up 175% and 80% since first listing respectively.

"Most conglomerates are not designed to digest acquisitions," Stephanie Wissink, Senior Research Analyst at Piper Jaffray, told Activist Insight. Platforms require specific skills, which are not limited to identifying the right targets. "You don't micro-handle every individual brand," Wissink said, but capital management is paramount "so that the cost of funding is lower."

Platforms with a record of successful acquisitions can borrow money for a takeover at lower rates than competitors, Wissink added, and are able to negotiate more aggressively.

> "A company cannot be a platform forever"

Autumn storms

By the end of the third quarter of 2015, it appeared that the light on platform companies had dimmed. Platform Specialty Products and Nomad Foods lost respectively 49.6% and 27.7% of their value in those three months, while in September, Valeant's stock was caught in a storm that wiped 70% off its value in two months. Many other platforms struggled in the second half of 2015.

Admittedly, some of Valeant's troubles were idiosyncratic. The drugmaker's stock collapsed over a political investigation into its drug pricing practices and short-reports from activists Citron Research and Bronte Capital. Citron was among the first to attack Valeant and, in November, went after another platform, Mallinckrodt Pharmaceuticals.

Speaking with Activist Insight, Citron's founder, Andrew Left, said that problems affecting both companies were rife within the sector. "Platforms in the pharmaceutical sector are a major problem," he said. "These companies are cutting research for short-term profits."

The pharmaceutical sector is a sensitive one since platforms are liable to grow their portfolio through acquisitions and not through the development of new drugs, and might be tempted to buy patented drugs and then hike their price. Both Valeant and Mallinckrodt did that.

"Mallinckrodt is the worst of the worst," Left believes, adding that the pressure US politicians have started to put on these practices is having a positive impact. However, he also concedes that, outside the pharmaceutical sector, things might be different: "It depends on the companies. I am not going to throw all the roll-ups in the garbage together."

Without openly citing platform companies, even veteran activist investor Carl Icahn expressed some doubts about an excessive focus on acquisitions in 2015. In a September video posted on his personal website, Icahn said issuers were now just buying other companies to show analysts that their earnings were increasing, instead of taking money they could borrow at low rates and investing it in new machinery, new equipment or workers. "It's financial engineering at its height," the activist added.

"Platforms in the pharmaceutical sector are a major problem. These companies are cutting research for short-term profits"

The platform's the limit

Sometimes activists think that platforms have grown simply too big. That happened to Illinois Tool Works in 2012, when Relational Investors called on the company to halt its trail of takeovers and instigated a breakup of the conglomerate.

"Platform companies need to understand and manage their investors' expectations in order to maintain discipline in their acquisition," Daniel Kerstein, Head of Strategic Finance at Barclays, told Activist Insight. "Partially due to the low interest rates, some platform companies haven't had to focus on integration of their targets. At some point [if you're going to buy and buy], the level of bureaucracy can become really tough to manage," Kerstein added.

In Kerstein's view, there may be a limit to a company's ability to grow through acquisitions, even though this limit could be across different sectors. "A company cannot be a platform forever," he commented.

Ackman's battle

Last year saw Pershing Square record its worst performance since its inception in 2004—even worse than 2008, when hedge funds all over were hit hard by the financial crisis. Platform Specialty, Nomad and, of course, Valeant, were among the activist's biggest losers, yet Ackman has defended his portfolio—and Valeant in particular—heartily.

In a December investor letter, the native New Yorker stood by his bet on platform companies. Indeed, he praised Nomad's recent acquisition of the non-UK assets of Findus and Platform Specialty Products' acquisition of Alent, while also expressing "a high degree of confidence" in Martin Franklin. The stocks Pershing Square was invested in were trading "at perhaps the greatest discount to their intrinsic value... since the inception of the firm," he noted.

Despite the major difficulties faced by well-known platforms, the year 2015 has not delivered a comprehensive verdict on this strategy. Shares in platforms such as Danaher, AB InBev, Liberty Media and TransDigm rose in the second half of the year—though not astonishingly.

Nor is there a common problem, or solution, for the platforms that struggled. Some may get by with small adjustments and resume buying again, while others may have to seriously reconsider their plans. Perhaps that is exactly what Martin Franklin had in mind when, in December, he decided to sell Jarden to Newell Rubbermaid for a cool $15 billion. ■

A bumper year for platform activism

Pershing Square Capital Management is not the only activist to have bet on platform companies in 2015. Corvex Management and Third Point Partners piled into Nomad Foods, while Nelson Peltz's Trian Fund Management has pushed industrial conglomerate Pentair to make acquisitions.

Another activist betting on the strategy is Jeff Eberwein's Lone Star Value Management, which spent $10 million helping the small but highly acquisitive IT solutions firm Ameri Holdings—known as Ameri100—go public. Speaking with Activist Insight, Eberwein explained that the company will benefit from a big trend in the outsourcing of IT services. "It's an exciting project of ours," he said. "The company has a lot of workers in India, so we can improve the margins of the business we buy."

For a platform, an activist's support can be useful. When Edgewater Technology rejected a $8.50 per share takeover offer from Ameri Holdings, Lone Star built a stake in the target and announced a consent solicitation to overhaul its board. In November, Edgewater announced a review of strategic alternatives and engaged in negotiations with Ameri.

Similarly, Sandell Asset Management wrote to the board of Viavi Solutions in September, noting "a value in excess of $12 per share could be realized if the company were to transition itself into a tax-advantaged 'platform company'." According to its proxy statement, Sandell was attracted to the idea by Viavi's large net operating losses, which would help it lower the cost of its acquisitions. The activist and the company reached a settlement in October.

Banking sector activist Clover Partners, by contrast, recently threatened a proxy contest to stop Wyoming-based Financial Institutions' trail of acquisitions and push the company to sell itself instead. In December, the hedge fund said Financial Institutions had justified a recent acquisition and the planned takeover of Courier Capital by arguing that it was buying platforms "with the potential for smaller tack-on deals." Clover Partners' criticisms notwithstanding, the Courier Capital deal was approved by investors in January.

Hedge funds and unsolicited bids

An article by the activism team at Houlihan Lokey.

It is well established that activist funds and private equity firms are not-so-distant relatives. Both are value-dislocation investors that seek opportunities to "do things better" to create value. This similarity has led to many activists trying on their private equity hats and making efforts to acquire public companies. Unlike many private equity funds, which are constrained by fund documents that prohibit unsolicited bids, hedge funds have the ability to make public unsolicited offers.

Using data compiled from Activist Insight and our own records, Houlihan Lokey examined the recent history of unsolicited bids by hedge funds. Although hedge funds are seldom successful in completing unsolicited acquisitions, the strategy has served as a catalyst for significant M&A. Indeed, of the 96 resolved situations involving an unsolicited bid by a hedge fund since 2005, 42.1% of these companies were eventually acquired—the majority by third parties. Only 9.5% of unsolicited bids by hedge funds ended with the company acquired by the investor.

Is this because companies are so horrified at the prospect of being acquired by a hedge fund they will run into the arms of anyone else? Are hedge funds any more than willing catalysts for a less hostile bidder? In fact, there are likely to be other factors at play. Activists routinely screen for companies which share the characteristics of many "selling" companies: declining sales, founder/insider exits, sub-scale players in consolidating industries, and, most importantly, companies struggling to close their discount to implied value. These screens are straightforward enough that activists do not need the whisper of a rebuffed acquirer to uncover vulnerable companies.

> "Unsolicited bids by hedge funds have been a catalyst for M&A"

Furthermore, upon the announcement of an unsolicited bid, bankers across Wall Street spring into action and actively solicit buy-side opportunities from clients with potential synergies, who can offer premiums boards cannot ignore.

Despite the success of unsolicited offers by hedge funds resulting in acquisitions, there has been a gradual decline in the number of these campaigns. We believe there are a number of reasons for this decline. First, with each faux effort to acquire a company, a hedge fund loses some of its future ability to "cry wolf." Second, only a handful of hedge funds have the capital (or access to capital) needed to actually acquire entire public companies. Third, unsolicited acquisition campaigns limit the optionality of hedge funds, as they cannot credibly pivot their campaigns to classical activist arguments.

Fourth, the growing influence of index funds has made it considerably more difficult to run unsolicited bid campaigns, as these institutions are generally opposed to unsolicited take-private transactions. Fifth, frothy valuations during the recent economic recovery have, overall, tampered down take-private transactions despite historically inexpensive access to capital. Finally, we believe that corporate boards have become more proactive in response to the prevalence of activism—taking action before an activist's involvement.

Even though the number of unsolicited offers by activists has been declining, we believe that the quality of the bids coming forward has improved, as the appetite for funds to complete acquisitions has expanded and the sophistication of activist funds in unsolicited transactions has increased. While it remains to be seen whether hedge funds will be more successful in acquiring companies, we would not be surprised to see additional hedge funds try on their naturally fitting private equity hats. ■

Proxy access: new sense or nuisance?

Proxy Insight

Proxy access took the governance world by storm in 2015, but opinions are still divided on whether it is worth fighting for.

The overview is staggering. In the past year, the number of S&P 500 companies with a proxy access bylaw adopted reached 117, or 21% of the index. Many would be forgiven for thinking that this rule's time has come, and its dominance of the market assured.

Much that has been written on proxy access is along these lines. Clare Payn, Head of Corporate Governance in North America for Legal & General, an insurer, suggests the issue is now central to how companies advertise their approach to investor relations. "We now see this issue as best practice, along the lines of majority voting and declassification of boards, and believe that all companies should implement access for shareholders as soon as practicable," she says.

Access to grind

Yet behind these admittedly remarkable statistics lies considerable tension. Rarely does a governance topic cause such differences of opinion as proxy access has, with big shareholders themselves divided about its merits; some concerned about unintended consequences and others worried about costs.

Few can see the bylaws being used in great numbers, yet for the California State Teachers' Retirement System (CalSTRS), a large pension fund and enthusiastic backer of proxy access, that is beside the point. "CalSTRS believes proxy access would serve as a useful tool that would enable shareholders to hold corporate boardrooms accountable," says Aeisha Mastagani, a corporate governance portfolio manager there. "While we believe proxy access will be rarely used, the CalSTRS position is that it is an important shareholder right that should be in place at all companies."

On the issue of activists exploiting the changes, Marc Weingarten, Co-Chair of Schulte Roth & Zabel's global Shareholder Activism Group, is skeptical. "Activists want their own proxy statements and proxy cards, they don't want just a short paragraph in the company's proxy statement," he says. "The proof that companies aren't afraid of proxy access is the number of companies adopting it."

Runners and riders

Shareholder proposals on proxy access came thick and fast in 2015, and foremost among the proponents was New York City Comptroller, Scott Stringer. NYC made 75 proposals during 2015, of which 66 went to a vote. Then there were regular governance campaigners Jim McRitchie and John Chevedden, who accounted for the bulk of a further 25 proposals.

What's notable is that management teams continued to oppose proxy access, even in the face of solid support. Of NYC's 75 targets, nine reached some sort of agreement before a vote, one company supported the motion (Apache), and another took no position (Republic Services). Yet the remainder continued to recommend shareholders vote down proposals—not wholly successfully.

The average level of support for these resolutions (excluding Apache and Republic Services) was an impressive 55%, with 41 companies receiving support of greater than 50% and five winning over 70%.

NYC's most successful proxy access resolutions, 2015

Company	% For
Avon Products	75.7
Visteon Corporation	75.7
First Energy Corporation	71.4
Cloud Peak Energy Inc.	71.1
Netflix Inc.	71.0

“Some companies and their lawyers are getting creative regarding provisions in the bylaws”

Interestingly, it seemed to make little difference whether NYC acted alone or in concert. A number of other organizations, such as Illinois State Board of Investment and the City of Philadelphia Public Employees Retirement System joined with Stringer on certain proposals—albeit with little effect on the voting results.

Other proposals were not so successful, however. While two of McRitchie's proposals won support from Hain Celestial and Citigroup, 23 companies recommended voting against, with mixed results. Two received more than 70% of votes cast in favor (St. Jude Medical with 72.5%, and Kohl's Corp with 73.2%), and ten received the support of a majority of shares.

Two proposals were withdrawn, but the average level of support was an impressive 48.3%.

What to expect from 2016

If companies thought they would be spared further proxy access resolutions in 2016 they will likely be disappointed. CalSTRS has already announced plans to engage with their 40 largest equity holdings on the subject, and will file shareholder proposals if necessary.

“Some companies and their lawyers are getting creative regarding provisions in the bylaws, and we wanted to see a useable rule adopted,” says Anne Sheehan, Director of Corporate Governance at the pension fund. “As with our previous engagements, the idea is to write a letter first and build dialogue, rather than just lobbing a proposal across the table.”

Nor is NYC done with the issue. It is understood to be focusing on 72 companies—36 new names and 36 of the 2015 list that failed to implement a suitable bylaw.

An innovation designed to increase directors' accountability to shareholders has already pitted contrasting views in opposition to each other. It remains to be seen whether an accommodation of sorts will be reached. ■

Backers and bolters

Investor/Voting Manager	Meetings	% For	% Against	They say:
BlackRock	87	93%	7%	Generally supportive, as long as mechanisms reasonable and not open to abuse by short-term investors or those looking to take control of the board.
Vanguard	85	18%	82%	Supportive of proxy access for shareholders holding 5% of a stock or more.
Fidelity Management & Research	78	0%	100%	Does not support proxy access.
JP Morgan	74	0%	100%	Supportive as long as ownership threshold is a minimum of 5%.
BNY Mellon	84	98%	2%	Generally supportive.
T. Rowe Price	66	98%	2%	Supportive of proxy access bylaws similar to SEC's 2010 rule. Believes it would act as a corrective to shareholder activism.
Northern Trust Investments	84	2%	98%	Approaches the issue on a case-by-case basis.
Wellington Management Company	64	5%	95%	Approaches the issue on a case-by-case basis.
Legal & General Investment Mgmt.	58	93%	7%	Sees proxy access as best practice, but will vote against proposals that deviate from the standard.
Norges Bank Investment Mgmt.	83	99%	1%	Believes shareholders should have the right to make binding proposals and call special meetings at all companies.

The table above shows how the ten largest equity investors voted on shareholder proposals for proxy access in 2015, along with their comments. While BlackRock, BNY Mellon, Legal & General and Norges all predominantly support the issue, Fidelity, JP Morgan, Northern Trust, Wellington and to an extent Vanguard all oppose. Rarely do we see such radically different positions from the top asset managers on a governance issue.

Activist Insight

Shareholder proposals

What investors were getting worked up about in 2016.

Not all activism is conducted through media appearances and highly charged meetings between CEOs and hedge fund managers. Indeed, the world of shareholder proposals is an increasingly important part of corporate life. Sometimes derided as a universe of gadflies for the small stakes some investors hold in companies, proposals can nonetheless signal changing attitudes to corporate governance—see the article on proxy access in this Review, for instance—and hit executives in the pocket when they seek to amend vesting periods or exercise price levels.

Action or no action?

In 2015, the issue of shareholder proposals took on new importance with a significant review by the Securities and Exchange Commission of its practice of granting "no action" letters to companies faced with shareholder proposals that conflict with their own. Regular proponents smell a rat. Jim McRitchie, whose proxy access proposal at Whole Foods Market sparked the review when management claimed SEC support for a proposal setting a very different standard, says in a submission to the review that any management proposals announced after a shareholder one should be considered counter-proposals and therefore ineligible for relief. John Chevedden, who was again the leading filer of proposals in 2015, agreed.

Institutional investors too are largely behind a narrow interpretation of what constitutes a similar proposal. Submissions from such funds as CalPERS, CalSTRS, Florida State and New York City all make the point that shareholder proposals are mostly non-binding, so can only be taken by management on an advisory basis. Even when management and shareholder proposals are placed on the same ballot, the results can allow investors to make their views known and are unlikely to be ambiguous, they say.

Nonetheless, a decision from the SEC is not going to be easy to come by. Corporate lawyers argue that denying companies the right to exclude proposals on proxy access alone would be a substantive change in the rules and have pushed for the SEC to make amendments through the Administrative Procedures Act, rather than through simple guidance, possibly taking a resolution to the issue beyond the 2016 proxy season. ■

Most frequent proponent of shareholder proposals

Proponent	Proposals in 2015	% Total
John Chevedden	94	7%
Comptroller of the City of New York	69	5%
Thorwald Arvidsson	49	4%
Kenneth Steiner / William Steiner	38	3%
Mouvement d'éducation et de défense des actionnaires (MÉDAC)	36	3%
Jim McRitchie / Myra K. Young	24	2%
UNITE HERE	22	2%
As You Sow	18	1%
Bliss Talent Investment Ltd / Tianrui (International) Holding Company Limited	18	1%
Walden Asset Management	18	1%

Popular topics

Topic	Number
Adopt proxy access right	134
Report on lobbying payments and policy	111
Require independent Chairman	67
Provide right to act by written consent	37

For more information, contact Activist Insight for a trial. If you want to go deeper still and find out who votes for shareholder proposals, inquire about our sister company, Proxy Insight.


Don't leave it to chance
Proxy Insight has all the intelligence you need for a successful shareholder vote. Understanding who votes, how and why puts you in control—so don't leave it to chance.
Proxy Insight
www.proxyinsight.com


60
50
10
40
20
30
55
5
50
10
45
15
40
20
35
30
25
0,2 s
16 JEWELS