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TRENDS IN ACTIVISM

Tyson McCabe
Director, Advisory Services
Thomson Reuters

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AGENDA: TRENDS IN SHAREHOLDER ACTIVISM

- Definition and brief history
- Prominent and new activists
- Top demands by Activists
- Activism historically and by sector
- Typical lures of activists
- How activists hide/operate
- Activist capital
- New age of activism
- How to defend your company against activists
- Key Takeaways for IROs
- Predictions

SHAREHOLDER ACTIVISM

What is Activism?

- Although shareholders don't run a company, they can exercise their rights as owners and influence the board of directors and management.
- Two major types: Governance and dissidence.
- Governance – push for better management of companies. Examples: calSTRS, calPERS, Calvert Funds.
- Began in the 1980's with the likes of Carl Icahn – morphed into a strategy.
- Dissident – tend to increase shareholder value through aggressive means. Prominent examples: Icahn, Relational Investors, Greenlight Capital, Starboard Value, Elliot International, GAMCO, Trian Partners.

Impact to IR teams

- On-going reality for many IR teams.
- IRO's skills are tested in the face of major changes for the corporation.
- Deployment of capital.
- Private + public funds partnering with dissident investors to manage their $.

Newcomers

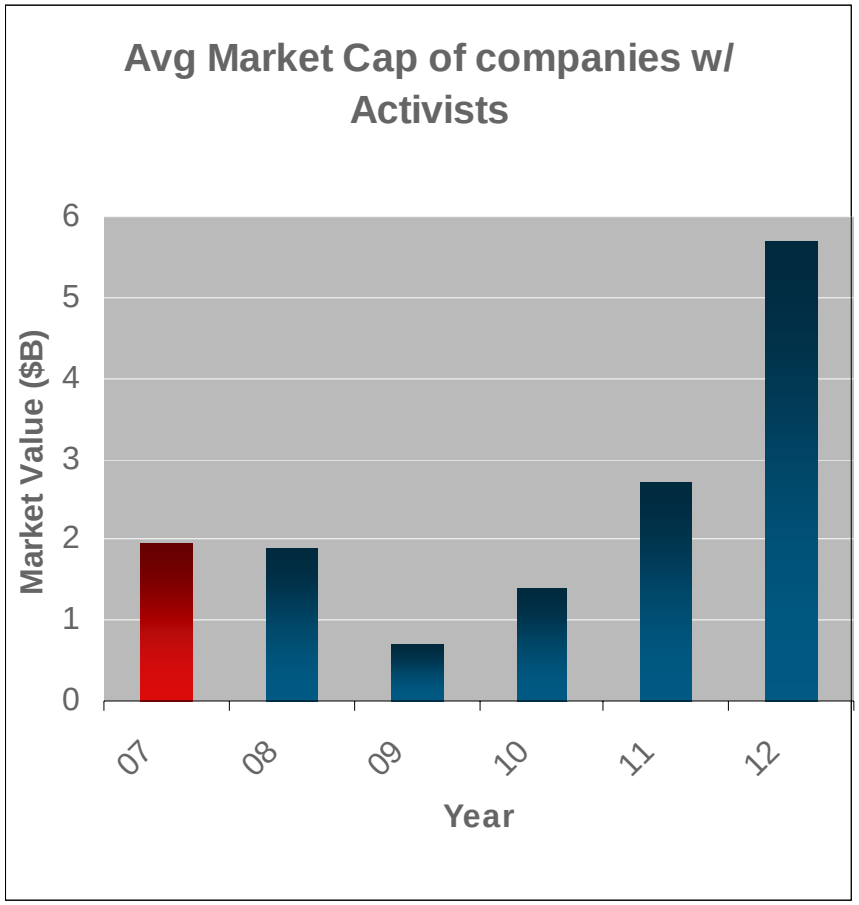
Expect more to embrace activism as a style

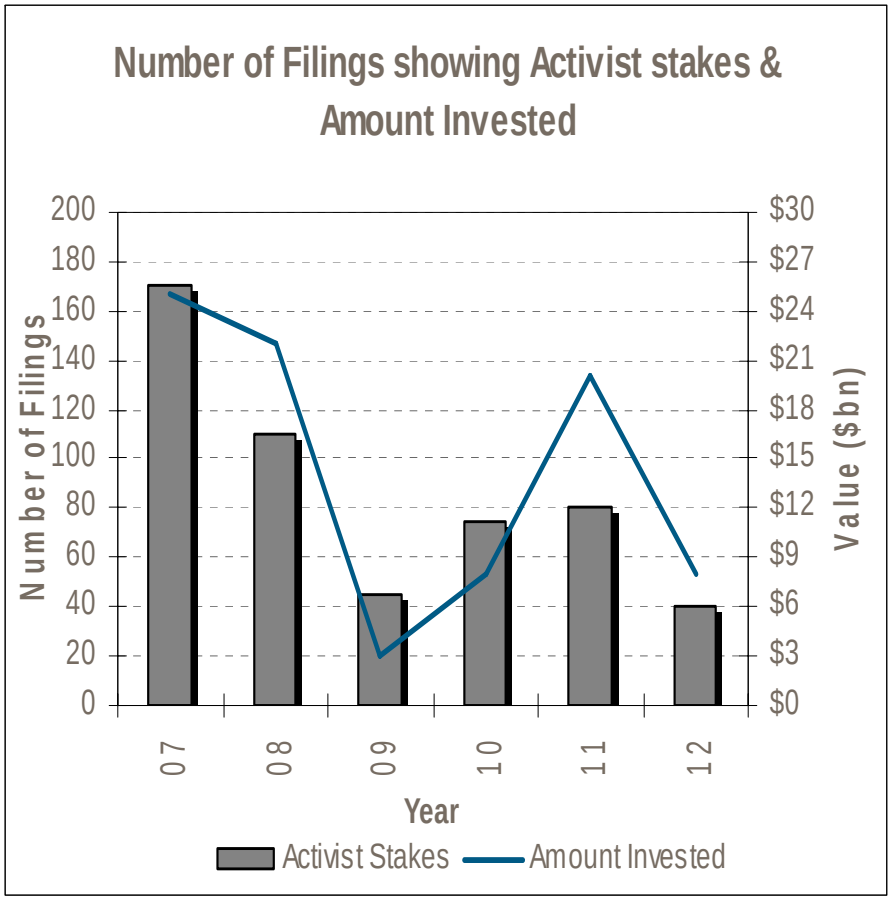
- Starboard Value, LP
- Corvex Management
- Marcato Capital Management

TOP DEMANDS BY ACTIVISTS

- Board Seat/ Control
- Change in Management
- Shareholder Rights
- Strategic Direction
- Special Dividend
- Sale of Company/ Assets
- Hostile Acquisition
- Removal of Poison Pill/ Staggered Board
- M&A

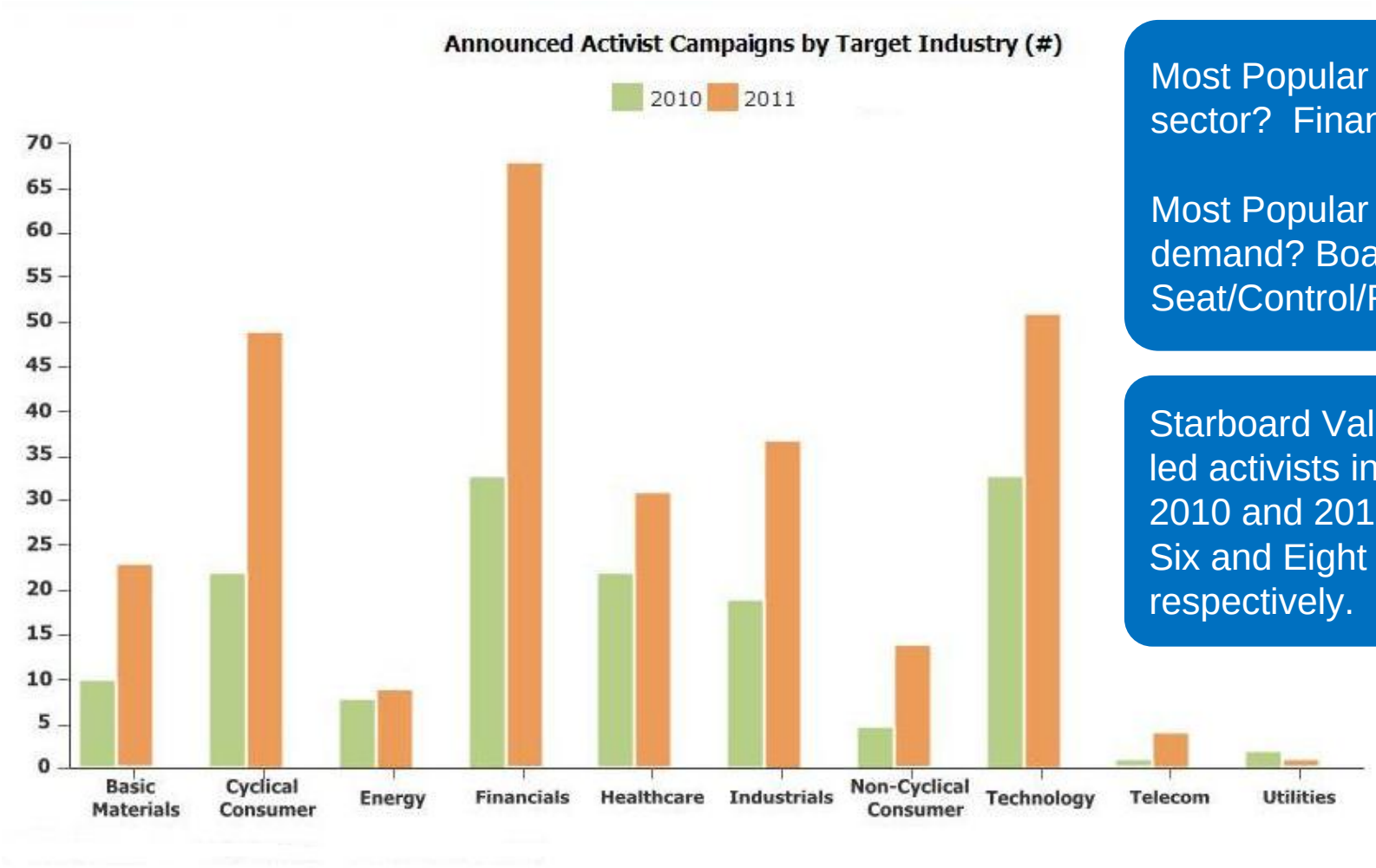
ACTIVISM HISTORICAL FIGURES





Source: 13D Monitor through 8/22/12

ACTIVISTS 2010-2011 BY TARGET INDUSTRY



Most Popular sector? Financials

Most Popular demand? Board Seat/Control/Rep

Starboard Value led activists in 2010 and 2011 – Six and Eight D's, respectively.

TOP FACTORS THAT ATTRACT ACTIVISTS

Activists are attracted to:

- Undervalued companies – low P/E multiples vs. peers.
- Companies going through a major change: CEO/crisis/restructuring.
- Controversial CEO – High compensation, outspoken/aggressive comments.
- Underperformance - Multiple quarters of missed guidance; History of accounting irregularities/governance issues.
- Board composition.
- High levels of cash/assets that can be easily monetized Declining investor sentiment.

Understand the Triggers/Methodology and their Motives

- Learn about their intentions.
- Some are long-term oriented.
- Others want the cash/sale.
- Often work with other investors to pool shares “wolf-pack.”

HOW ACTIVISTS HIDE

Working Together "Wolf-Pack" Strategy

- Multiple hedge funds activists work together to force change on a target company
- Examples include: Third Point, Royal Capital and Monarch – Smurfit-Stone; Carlson Capital and Becker Drapkin – Ruby Tuesday, Corvex and Marcato – Corrections Corp. of America, Icahn and SEAM - Chesapeake

SEC exemption

- Top investors can 'hide' their holdings if disclosure would likely cause "substantial harm" to their competitive position – fear of copycat trades
  - Sample Filing:
    http://sec.gov/Archives/edgar/data/921669/000114036112037103/form13fhr.txt
- At least 50 money managers/hedge funds requested exemption in 2011
- Examples include Buffett and $10.7 billion investment in IBM, Relational Investors, activist hedge fund run by Ralph Whitworth and its investment in Hewlett-Packard (who now has a seat on the board)

HOW ACTIVISTS HIDE (CONTINUED)

Use of different investment vehicles to acquire significant positions

- Stock or a combination of stock and options are most common
- Often, options are acquired OTC and may not trade in the open market
- Usage of broker-dealer swaps to defer filing requirements; Pershing Square in JCP, The Children's Investment Fund in CSX
- Use of options greatly decreases capital required to launch campaign as well as allows for less impact to underlying equity
- Not as common, but convertibles or other debt structures

ACTIVISTS CAPITAL

Activism as a desired means of investment style

- Firm's are attracting a significant amount of new Capital
- Activists maintain significant amounts of cash
- Dividend income not to be overlooked

SHIFT FROM TRADITIONAL "D-STYLE" ACTIVISM

No longer need a 13D to get a company's attention; new corporate governance rules have shifted the balance.

- Pershing Square's recent position in PG; though significant at $2B it is only 1% of shares outstanding. Relational Investor's recent stakes in PEP and HP – the latter resulted in a board seat
  - Growing reputation and relationship with mutual fund community
  - Negative stigma decreasing
- Use of letters to the board, investor meetings or phone calls to push specific activist-type agenda's with little-to-no position: Clinton Group

HOW ACTIVISTS OPERATE

Institutional Investors – Corporate Governance Sensitive

- Measured against market indices, e.g. S&P 500, Russell 2000, etc. and multi-year time horizon
- Management fee on assets under management
- Tend to avoid unfavorable/contentious publicity
- Increasing support of Corporate Governance agenda, e.g. “majority vote” and “board de-classification”
- Will consult proxy voting agency firms Glass Lewis/ISS but corporate governance officer influences/votes shares

Hedge Funds – Dissident Investors

- Tied to a “target” return; typically shorter investment horizon vs. other investors
- Outsized management fee on excess returns
- Conduct activism in the public domain
- Aggressive style with management
- Leverage ISS/Corporate Governance issues to gain institutional investor support
- “Wolf-pack” mentality

HOW TO DEAL WITH ACTIVISTS

Prior to Activism

Prevention

- Create an internal response team to address potential instances of shareholder activism
- Monitor your shareholder bases and proactively manage relationships with top investors
- Build a unified message that addresses investor concerns
- Network with other IRO's
- Consult proxy solicitation firm's such as Alliance Advisors or Georgeson
- Thomson Reuters' Surveillance/SSAP
- Consider ongoing questions and tone at meetings

After a Public Approach

Understand their concerns

- Communicate with the activist; do not ignore and hope they will go away
- Carefully review the proposals
- Gauge shareholder support/rotation
- Determine the appropriate response: formulate the response with supporting arguments
- Implement the plan
- Continue to speak with shareholders and gather feedback regarding strategic & financial plans.

Common Defensive Tactics

+ Adopt a Poison Pill
+ Create a Staggered Board
+ Remove Cumulative voting
+ Create multi-class shares

KEY TAKEAWAYS FOR IROS

Communicate with and listen to shareholders

- Year-round engagement with investors
- Provide regular updates to the Board

Reach out and understand shareholder concerns

- Investor sentiment towards corporate governance, business performance, market outlook (consider a perception study)

Remain informed:

- Actively monitor trading activity
- Understand Activists' Strategies & Tactics
- Routinely monitor activists activities/overtures

Develop a Defense Manual

- Have a formal communication plan in place
- Consider defensive strategies: poison pills, staggered boards

KEY TAKEAWAYS FOR IROS (CONTINUED)

Know your shareholder base/gather feedback

- Who are your top shareholders? Governance contacts?
- What are their concerns?
- Who are top investors? What are their triggers?

Improve disclosure & communication

- Actively engage with investors year-round, not just prior to proxy season.
- Don’t be quick to dismiss or ignore activists.
- Align executive pay with performance.
- Provide updates to your Board of Directors.

INCREASE IN ACTIVISM EXPECTED FOR 2012 & 2013

Expect increased shareholder activism

- Likely increased activity from dissident investors
- Low valuations and decreased tolerance for even short-periods of underperformance or perceived poor management - U.S., Canada
- Low M&A environment
- Record cash on balance sheets
- Mutual fund managers likely to turn increasingly dissident to demonstrate accountability for current investments
- Rise of ‘D-less’ activism
- Changing landscape in company responses

QUESTIONS?

CONTACT US

THOMSON REUTERS

Tyson McCabe
Director, Advisory Services
Tyson.McCabe@thomsonreuters.com
+1.646.822.2675