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TRENDS IN ACTIVISM

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AGENDA: TRENDS IN SHAREHOLDER ACTIVISM

- Definition and brief history
- Prominent and new activists
- Top demands by activists
- 2012: A year in review
- How activists hide/operate
- Activist capital
- Typical lures of activists
- How to defend your company against activists
- Monitoring market expectations
- Key takeaways for IROs
- 2013 Predictions

Activist Investment Landscape

- Thomson Reuters identified 205 firms globally with ~\$1 trillion in assets that have displayed activist investment tendencies
- Two types of activist investors:
 - Public Pensions – Push for better corporate governance
 - Long-term focused investors that have diversified portfolios
 - Examples: CALSTRS, CALPERS, Calvert Funds.
 - Dissident – Look to unlock shareholder value through more aggressive means
 - Tend to take positions for the very purpose of activism

Tier 1 Activist Investors

- Carl Icahn
- Relational Investors
- Pershing Square
- Elliot Associates
- ValueAct Capital
- Jana Partners
- Trian Fund Mgmt
- Third Point

Newcomers

Expect more to embrace activism as a style

- Starboard Value
- Corvex Management
- Marcato Capital Management
- Engaged Capital

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

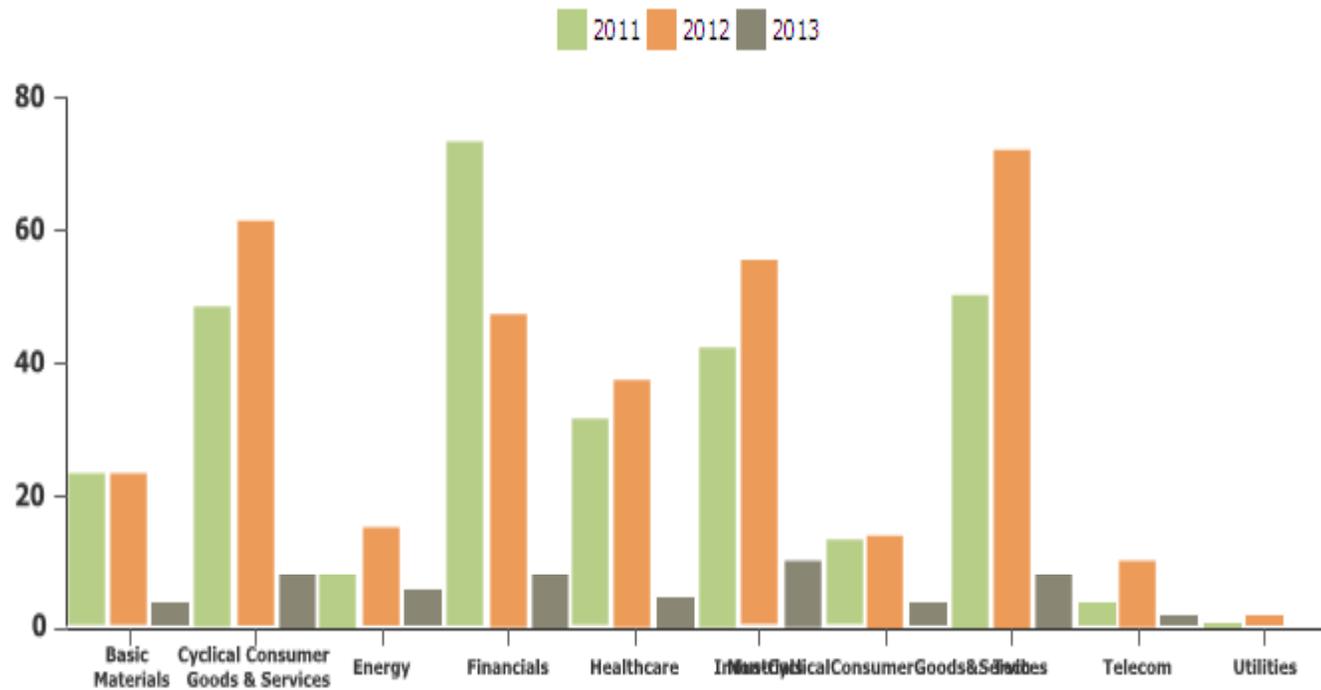
2012 Activism Results

- Shareholder activists launched 219 proxy campaigns, the most since 2008
- Activist investment firms averaged 25% returns, outperforming the S&P 500 by 12%
- High returns attracted about \$3.8 billion of investment to activist funds in 2012, compared with a net \$1.8 billion in 2010

ACTIVISTS 2011-2012 BY TARGET INDUSTRY

Activist Campaigns By Industry

Activist Campaigns By Industry (#)



Note: Industries based on the target's TRBC Economic Sector. Current year information is YTD

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
- 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 as well as getting creative in doing so
- Activists maintain significant amounts of cash
- Dividend income not to be overlooked

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 issue
- 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”

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
- HSR as a indication for potential Activist intent

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

Monitoring Market Expectations



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SSAP OPTIONS ANALYTICS

XYZ 3.8.13

March 8, 2013	Close	Chg	% Chg	Open	High	Low	Volume
XYZ Inc	\$14.16	(\$0.06)	-0.42%	\$14.29	\$14.34	\$14.13	18,376,349

- ▶ **Expectations on Timing/Price:** With additional information becoming public on the XXXX situation, traders were selling calendar spreads to express their deal timing biases. A trader sold 9,000 Jan '14 15 calls, collecting \$0.38, while at the same time buying 9,000 Aug 14 calls paying \$0.69. The \$0.31 package is a pure volatility bet that the Jan '14 15 strike is elevated relative the Aug 14 strike. The trader believes there will be a resolution to the buyout proceedings by the August timeframe and investors have clearly over estimated deal timeframe changes.
- ▶ **Skew Takeaways:** There were no dramatic shifts in the implied volatility skew curves today out to August.
- ▶ **Today's Options Activity:** Total volume of 81,159 contracts vs. a 20-day average of 75,611 contracts.



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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 2013

Expect increased shareholder activism

- Likely increased activity from dissident investors
- Shift from traditional “D-style” activism
- 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
- Changing landscape in company responses

QUESTIONS?

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