



Activism Monthly

...your monthly digest of activist investment

Third Quarter Special

Review: a busy third quarter and a corporate fightback?

In this special quarterly edition of *Activism Monthly*, we track and uncover recent trends in shareholder activism. In particular, we:

- Analyze new findings on the results of shareholder activism,
- Analyze the kinds and results of activist campaigns in quarter three, and
- Provide an insight into the kinds of activism to be expected in quarter four.

Activity rate

As anticipated, the number of Schedule 13D filings (i.e. initial disclosures of US activist positions) fell in quarter three, from 33 in each of the first two quarters to 25 (see figure 1). The number of activists disclosing new stakes increased slightly, however, suggesting a burgeoning field. In 2012's third quarter, 19 activists filed initial Schedule 13D forms, with Bulldog Investors and Discovery Group accounting for nearly a third between them. In quarter three of 2013, on the other hand, no activist filed more than two, with 23 activists breaching the reporting threshold of 5% of the company's outstanding shares.

Similarly, the number of activists busily building their positions with amendments to Schedule 13Ds rose from 52 in the third quarter, 2012, to 60 in the third quarter, 2013. This could indicate greater activity in acquiring and disposing of stakes, or more hands-on campaigns (since 13D Amendments can indicate either that activists have crossed reporting thresholds or that they have taken their campaign public, for example by sending a public letter to the board).

	Q3 2012	Q3 2013
Initial 13Ds	19	25
13D Amendments	166	184

Figure 1. Rate of activism in US through 13D filings.

Either way, the data confirms Carl Icahn as the foremost activist investor in the world. The Chairman of Icahn Enterprises and antagonist of Dell Inc was again the busiest

activist, with 33 13D Amendments in the last three months, compared to 21 in the same period last year. Starboard Value was the nearest competitor, with 15 13D Amendments in the three months just gone, and nine in quarter three, 2012.

Activist investors around the world began 81 campaigns in quarter three, an increase of 37% on the same period last year. The number of companies targeted by activists also grew, but by 30%. The apparent trend of activists making more detailed public recommendations for the companies they invest in - spotted by Activist Insight earlier in the year - appears to be borne out by these numbers.

Campaign tactics

Buoyed by increasing publicity and with a number of newcomers determined to make a mark, activists took more aggressive stances in the third quarter of 2013, when compared with the same period a year ago. Attempts to change the composition of company boards increased from 1 to 4 instances, while the number of campaigns designed to get activists on company boards doubled, rising from 12 to 23.

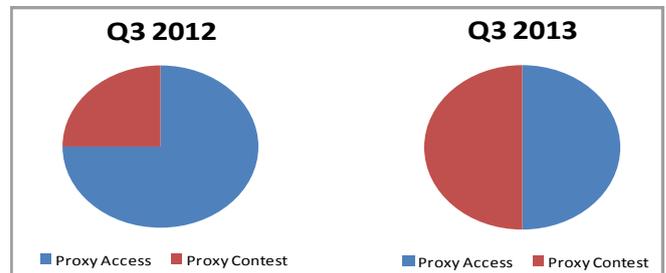


Figure 2. Outcome of attempts to gain board representation

However, there are signs of a fight back from companies. In 2012, nine of the twelve attempts to gain board representation started in quarter three ended with the company offering the activist seats through the official proxy. In campaigns started in quarter three, 2013, as many activists fought proxy campaigns as were granted proxy access (see figure 2, above). *Cont...*

This will be good news for law firms. Earlier this year, Olshan Frome Wolosky claimed it had had the 'busiest and most successful proxy season on record', advising on 21 proxy contests. Schulte Roth & Zabel weren't far behind, advising on 15 proxy fights.

As in quarter two, activism has also shown itself to be influenced by the widespread expansion of balance sheets. With companies hoarding record piles of cash, the number of pro-dividend or share repurchase agreements has more than doubled from 6 to 13 between the third quarters of 2012 and 2013.

Featured Tactic—Remove CEO or Board Member

CEOs must fear few things more than being personally singled out for criticism by an activist shareholder. Activists have been successful more often than not, with three out of five seeing off CEOs in the past three months, and six of seven in the same period a year ago. CEOs might be pleased to learn, however, that of campaigns launched in quarter four last year, five activists were unsuccessful and one withdrew their demands from ten attempts to unseat management. Only two could claim full success, suggesting that the tactic might be used more speculatively in the run-up to proxy season.

Removing a CEO or board member is one thing. Replacing them is another, as Dan Loeb and Bill Ackman have recently discovered. Loeb was reportedly instrumental in the appointment of Marissa Mayer at Yahoo, but the two reportedly fell out, leading Loeb to divest his shares in the

company. (For more on Loeb's attempt to unseat Sothebys' 'imperial CEO', William Ruprecht, see our featured campaign on the back page of this report). Ackman attempts to remove CEOs more often than any other activist (five in the past four years). When he recently complained that too much of the blame for JC Penney's leadership choices had been placed on him, the board was unimpressed and faced him down rather than lose interim-CEO, Myron Ullman.

Bulldog Investors currently have several campaigns targeting company bosses. In particular, the hedge fund would like to fire Firsthand Technology Fund's Kevin Landis, who Phil Goldstein calls a 'terrible money manager'. However, as Goldstein readily admits, for his campaign to work, the CEO has to lose the confidence of more than one shareholder, no matter how blunt the activist might be.

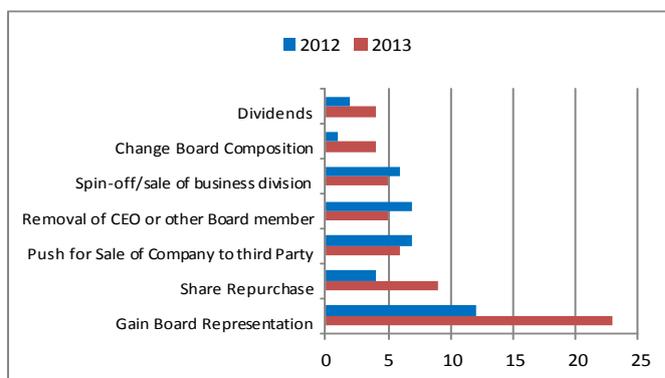


Figure 3. Frequency of select activist actions, Q3 2012 and Q3 2013.

Activist Insight product update

Activist Insight continues to develop into the world's leading resource on shareholder activism based on feedback from its subscribers. While we continue to work on future enhancements to the service, we are pleased to announce the following upgrades have now been completed:

- **Improved news coverage** – Our journalists reach for their address books on a daily basis to bring you updates direct from activists, including exclusive interviews with the likes of Clinton Group's Greg Taxin and Bulldog Investors' Phil Goldstein.
- **Follower returns**—Our database extracts daily share price information to show how companies targeted by activists performed after 13D disclosures. Plus, search by sector or campaign type and outcome to find out which activists deliver the biggest share price increases.
- **Intermediaries** – Subscribers can now see which law firms advise activists on their proxy contests.
- **Improved search functionality** – Campaign and company profiles are now searchable by industry and exchange listing, with over 30 exchanges including separate London AIM and LSE listings.
- **Improved Profiles** – Comments from activists explaining their engagement with targeted companies are now being rolled out, giving greater insight into how activists work.

To take a look at our new features, please visit our website at www.activistinsight.com to arrange a free product trial.

This newsletter represents a taste of our daily news and data service. To arrange a trial, visit www.activistinsight.com/freetrial

Interview: how to be a shareholder activist

Clinton Group Inc is a big player in shareholder activism. The hedge fund has placed 27 directors on the boards of 10 companies, removed eight CEOs and got seven companies sold. Greg Taxin, the fund's President, recently spoke at Schulte Roth & Zabel's annual conference on shareholder activism. Here, he talks to Activist Insight about how he engages with companies.



Clinton Group aim high. Consistently one of the best-performing activists, it looks for situations where it can double its money and often does better. According to Activist Insight data, the fund's activist investments since 2010 delivered an average annualized share price increase of 68% from the date they were first disclosed (see figure 1). Factoring in potential value creation in the pre-disclosure period, Clinton Group's actual profits may be even higher.

So it is with good reason that Clinton Group's President Greg Taxin is fervently committed to the belief that activism is a profitable strategy. As an intellectual battle rages in the Harvard Business Review and on CNBC about the merits or otherwise of shareholder activism, Taxin says the reason activism's profile is so high is simple; it works.

Indeed, Taxin is happy to tell Activist Insight that he thinks activism should be more widespread. "Adding a few activist scenarios can add alpha to your fund", he says. "You don't have to have a whole portfolio of activist investments like Clinton Group; there are lots of smaller activists and value funds that follow activists out there."

What about the notable failures for shareholder activism over the summer? Taxin's own approach to activism is lawyerly, befitting his early career and Harvard Law education. He says corporate charters offer openings for creative and legally-savvy investors, while during a proxy contest, activists are best served pressing home on the topics management would prefer to ignore, rather than responding to each and every retort.

Clinton Group has a six-part plan for an activist scenario, Taxin explains. First, pick a company with a solid foundation, preferably in a growing market or with good assets. Second, identify the reasons it is underperforming, whether they include operational mistakes or the team in place. Weigh the risk-reward trade-off; Clinton Group wants its investments to double in value, but typically expects a limited downside. Determine what concrete suggestions one could make to the company, whether

operational fixes or changes to the capital structure such as dividends or share repurchases.

Taxin says the final two parts are the most crucial, and where other activists often go wrong. Before investing, he says he needs to be sure that he has the ability to influence a company, and therefore avoids companies with large insider ownerships or satisfied shareholders. Perhaps most importantly, however, he always has an escape plan; companies with limited liquidity are hard to get out of, so Taxin looks for a high volume of trading.

These six steps hardly represent a fixed routine, but then, as Taxin admits, "every campaign is a little different. We aim, quite intentionally, to stay under the reporting threshold in a lot of scenarios." Stubbornly underperformers, such as NutriSystem, can force Clinton Group into action however. "They're a very co-operative board", says Taxin. "We approached them in 2012 and laid out the facts about their performance and the board accepted our conclusions within weeks. We have so much confidence in management, we've been pushed over the threshold."

Schulte Roth & Zabel held its fourth Annual Shareholder Activism Conference on October 3, 2013. Partners Marc Weingarten and David E. Rosewater, arranged the conference and invited the high profile guest speakers.

Fig 1. Clinton Group's best performing activist targets (source: Activist Insight Follower Returns data)

Company	Duration (time since first 13D)	Change in stock price (%)	Annualised change in stock price (%)
Current investments			
Quality Systems	3 months	13	65.08
Abraxas Petroleum	11 months	22.38	27.24
Wet Seal	13 months	31.88	29.05
Digital Generation	16 months	57.88	39.29
EveryWare Global	4 months	14.11	44.87
Exited investments			
Red Robin Gourmet Burgers	8 months	34.6	46.51
Radian Group	12 months	113.24	112.79
Inteliquent	4 months	110.11	856.68

Analysis: Compromise aids shareholder profits

Boards that compromise with activist shareholders perform better than those that dig in. That was the conclusion of research carried out by Activist Insight last month.

US companies with activist shareholders experienced bigger improvements in their share price if they compromised with demands made by activist shareholders, according to data from Activist Insight’s new Follower Returns feature. Thirty instances of US companies reaching a settlement agreement since 2010 produced an average annualised share price increase of 60% - outperforming the S&P by 44 percentage points over a comparable period (see figure 1).

Clinton Group’s Greg Taxin says he’s unsurprised by the findings. “There’s always benefit to institutional memory”, he told Activist Insight, referring to the benefits of being a company insider. “We never take the position that we have a monopoly on the truth. However, the issue arises for the activists when you can’t even have that dialogue. Then you have to decide whether to accept the status quo or duke it out [in a proxy contest].”

Out of resolved campaigns worldwide, activists were successful in achieving their objectives 211 times and partially successful 42 times out of 476 activist actions between 2010 and 2013. Only 131 activist actions were unsuccessful, or resulted in the activist withdrawing its demands (see figure 2).

In the US, successful activism produced an average annualised share price increase of 26%, while partial success brought gains of 32%. There are currently 62 ongoing campaigns.

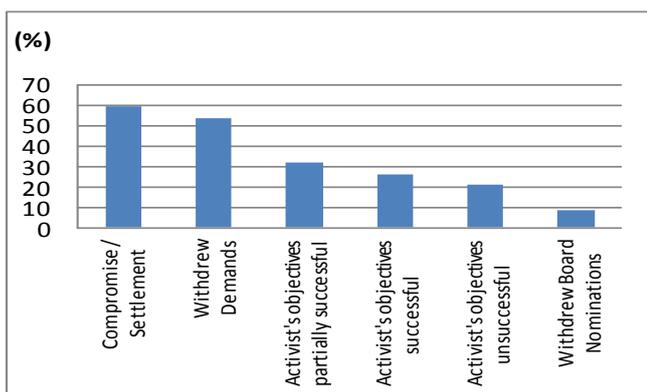


Figure 1. Performance of US companies by activist campaign outcome (% share price annualized increase from day of first 13D disclosure).

One high profile recent settlement was at Office Depot Inc, where Starboard Value was looking for board representation. The activist was offered board seats before a proxy contest had run its course, and though the company may well have lost the proxy contest had it not capitulated, the markets recognised Office Depot’s wisdom in bowing to the inevitable. Shareholders in the

company have seen the value of their investments rise by 90% since the day the activist filed its first 13D.

A Starboard representative said that compromise could be in the best interests of both activist and company, but disputed that the Office Depot scenario was really a settlement, with an agreement coming when victory was all but assured. Nonetheless, from a market perspective, a settlement agreement often means more stability than an outright victory for activists, since both sides have something to lose by resuming hostilities.

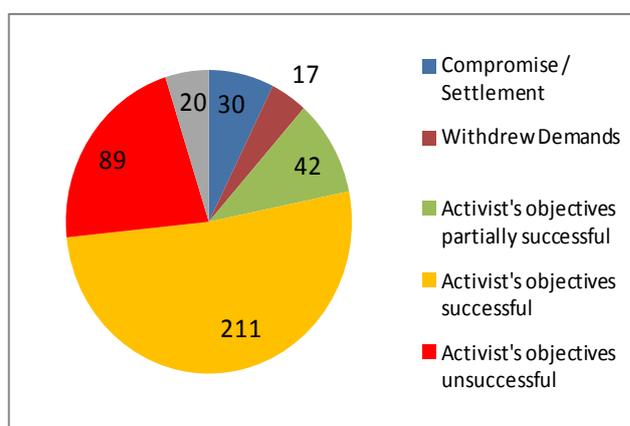


Figure 2. Number of resolved campaign outcomes (US targeted companies)

Staying put after an activist has been defeated might be the worst decision a passive shareholder could make. In instances where activists were unsuccessful in impressing the need for change on company boards, the share price grew by an annualised average of 15%, just 1.5 percentage points more than the S&P over comparable periods.

Pershing Square Capital Management’s hasty divestment of JC Penney last month, after Bill Ackman’s attempts to find a new CEO were blocked, was a case in point. With the board publicly voicing their opposition to Ackman, he was forced to step down from the board. A string of mistakes and poor financials followed, further depressing investors. No wonder Ackman announced a settlement agreement with Air Products & Chemicals just weeks later.

When activists withdrew their board nominations, it was apparently more often in despair than relief. Companies in that position saw their share prices go up by an annualised average of just 7%, ten percentage points shy of the comparable S&P average.

The apparent reality is that both activist and board usually have something to say to each other. Compromise can lead to that blend of insider insight and the strategic thinking offered by independent shareholders which is critical for success. Unfortunately, it often needs a long proxy fight for board and activist to see eye-to-eye.

Quarterly outlook: Sowing season

The summer of 2013 may go down as the summer of activism, such as the media attention focused on the likes of Carl Icahn, Bill Ackman (Pershing Square) and Mason Morfit (ValueAct). Even European activists like Cevian have become almost household names. Several major campaigns have been brought to an end—those at Dell and JC Penney come to mind—but others rumble on, including Morfit's at Microsoft. In fact, Activist Insight is currently tracking 36 ongoing campaigns started in the last three months alone. The denouement of these campaigns, as well as the likely addition of new stakes in anticipation of 2014's proxy season, mean that a lot could still happen in quarter four.

Increase in number of initiated campaigns

Last year there was significant growth globally in the number of companies targeted by activist investors from quarters three to four. If the same rate of growth (from 44 companies targeted to 67) were repeated again this year, we can expect over 120 campaigns to be initiated in the next three months.

Of course, the rate of increase in activism is highly dependent on other factors. Much of the growth of activism has been conditioned by low interest rates. Cheap credit means more firepower for activists, while companies hoarding cash present attractive targets for share buyback or pro-dividend campaigns. Indeed, Carl Icahn has recently called the opportunity for Apple to borrow \$150 million at 3% in order to fund a repurchase program a 'no-brainer'.

Florian Schönharting, an activist investor with NB Capital, thinks that M&A activity might crowd out activism in companies with smaller capitalizations, however. He points to the recent acquisition of Onyx by Amgen as an example, but says there are still opportunities for activists, who can often move faster.

One campaign tactic where growth seems almost inevitable is the desire for board representation. Last year, there were two-thirds more of this type of campaign initiated in quarter four than in the preceding three months. As noted in the previous article, activists have become more keen year-on-year on gaining board representation, so we can probably expect something like 30-40 attempts to gain board representation globally. Depending on the strength of companies targeted, perhaps half of these could see proxy contests.

Run-up to a new proxy season

Perhaps the most predictable proxy campaign of the new season is Sadar Biglari's at Cracker Barrel Old Country Store. Biglari has already tried and failed to get on the board twice, but now has a nearly 20% stake in the company. The few hundred thousand extra votes won't necessarily swing the

contest, given that 90% of shareholders other than Biglari Holdings supported management last time around.

Bulldog Investors has a number of investments that could end up as proxy contests, including increased stakes at Javelin Mortgage Investment Corp and Firsthand Technology Fund. Phil Goldstein told Activist Insight he struggled to say which investment managed its money the worst.

One investor getting its challenge in early was Sahn Adrangi's Kerrisdale Capital. Kerrisdale announced that it would run an alternative slate at Morgans Hotel Group, although the likelihood is that Yucaipa's Ron Burkle will ultimately choose the nominees. At the heart of the matter is a surprise victory in a proxy contest earlier this year by OTK Associates. Since gaining control of the board, OTK has stalled a strategic review, much to the annoyance of Kerrisdale and Burkle, who accused the board of acting like a spoiled child. Adrangi told Activist Insight that the 'overwhelming majority of shareholders' oppose the board, so there is likely to be a fairly intense battle.

Campaigns to watch out for

A number of large investors have ongoing campaigns that could be resolved in quarter four. As well as the aforementioned Carl Icahn and his preoccupation with Apple, JANA Partners only recently disclosed a stake in Safeway (calling for dividends and the sale of certain business divisions). Clinton Group are, as ever, among the busiest activists, with a number of new campaigns over the last few months, including calls for a share repurchase at WetSeal, and dividends from NutriSystem. Up until now there has been little progress for Triam Fund Management, as Nelson Peltz continues to argue for a merger of PepsiCo and Mondelez.

In Europe, The Children's Investment Fund remains a major player, continuing in a September 17 letter to press EADS (Airbus) to sell its stake in Dassault Aviation. Elliott Management, whose legal battles are not for the faint hearted, has set its sights on Vodafone's takeover of Kabel Deutschland. Its lawsuit against Terex's takeover of Demag Cranes is still ongoing after two years.



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Carl Icahn's on it - you have no excuse.

Avoiding Dell Drama - A Case Study

RotaryGallop

In this guest article, Rotary Gallop's CTO, Guy Tal, and CEO, Travis Dirks, explain how their analysis of Dell's voting register highlighted that the management buyout would not win a shareholder vote without a change in the voting standard.

Around July 17, 2013, after months of high profile headlines and one of the biggest proxy battles ever, Michael Dell and Silver Lake finally came to understand two key facts that Rotary Gallop has known [and made public](#) over [five months prior](#). First, they were going to lose the shareholder vote on a \$24.9 billion bid to take Dell private. Second, the reason would be a previously little-discussed rule involving the treatment of abstaining votes. We know it took Dell's team this long to realize their position, because it was only on July 24 that they made an increase in the purchase price contingent upon a demand that the rules of the game be changed. Most likely, they only realized their position by counting the number of abstentions as they came in.

So how did a startup figure out what the best team money can buy took months to learn the hard way? Rotary Gallop pioneers the application of Nobel-prize winning mathematics to the problem of acquiring, keeping, and exercising corporate control with empirically tested algorithms that *replace* guesswork with proven analytic techniques to remove blind spots. Here is how we predicted Dell's situation:

In January, Rotary Gallop calculated that Dell had an *RG Whale Score* that put it in the top 5% of all companies in the S&P500. The *RG Whale Score* measures a company's vulnerability to its largest shareholders – a clear indication in this case that shareholder opposition was a primary risk in the event of a proxy battle.

By mid-February, it became clear (to us) that the opposition had a significant chance of winning the battle. The day T.Rowe Price joined Southeastern Asset Management in opposition to the Dell transaction, we took a public list of Dell shareholders and the knowledge that these two shareholders were against the transaction, and *measured* their control and likelihood of voting the deal down. Together Southeastern and T.Rowe Price had a 93% chance of winning this shareholder vote, and had the deciding vote in (i.e., controlled) 86% of all possible outcomes.

Next we analyzed Michael Dell's chances of winning and observed that low abstentions halved his chances and more realistic abstentions worsened them 10-fold! [Below is a graph of this effect](#) (figure 1), published as the rest of the world wondered why Dell was insistent on changing the rules around abstention. Under the old rules, abstention caused a deep nonlinear depression in Dell's odds of success, while under the new rules it hardly affected the outcome at all.

Knowing the odds of proxy success a priori is indispensable for activists and defense to create an ideal negotiating stance. Using these odds as a starting point, our tools can also point to the right proxy strategy by measuring the effect and relative importance of key variables that affect a proxy campaign – the impact of ISS, retail campaigns, arbs, abstention, etc.

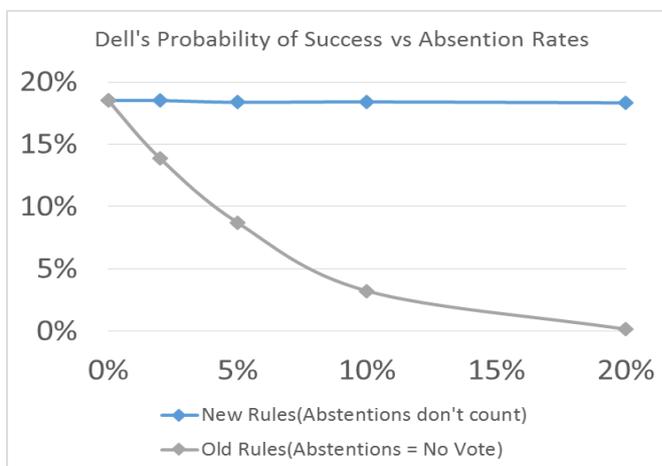


Figure 1: This graph reflects the entrance of Icahn and the new independence of T. Rowe price at that time. X axis - shares abstaining (%). Y Axis - probability that Dell's bid passes a shareholder vote. (Updated Calculations for publication in Quartz on July 31).

About Rotary Gallop:

Rotary Gallop specializes in the direct calculation of shareholder control and chances of winning a proxy battle to guide strategy in hostile takeovers, activist situations, corporate defense, and contested M&A transactions. Our insights are grounded in the scientific method and domain expertise, and powered using big data & quantitative tools.

What YOU need depends on the stage of your contested situation:

Pre-game: Your goal is to understand the distribution of control at the company in question and which groups may have enough control to swing the outcome. We recommend our Control and Vulnerability Database. Single company reports are available as well as industry and sector datasets.

Game On: The considered or anticipated contested situation has appeared and your primary responsibility is to determine the basis of your negotiation stance and strategy. We can use your team's best information to calculate your odds of winning ahead of time and help identify pitfalls to avoid.

Strategy and Tactics Deep Dive: Once you've decided to fight a battle it's time for a dive into the areas critical to your success. These differ from battle to battle, but some common things we analyze are: the top 20 shareholders' control, ISS's effective control, ROI of a retail shareholder campaign, and the effect of abstention.

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Email info@RotaryGallop.com, subject: "AI Free Report for Your Name" for a free sample of our individual-company Control and Vulnerability Reports.

Discount Code for Activism Monthly readers good for 10% off any purchase within the next 3 months: LeviCivitaAI3M

News in brief: our monthly round-up

New Investments in September:

Activist	Company	Stake
JANA Partners	Safeway	6.20%
Blue Harbour Group	Chico's Fas	5.60%
Clinton Group	NutriSystem	5.20%
Bulldog Investors	Helios Strategic Income Fund	5.80%
Elliott Management	Kabel Deutschland	10.91%
Sandell Asset Management	Bob Evans Farms	5.10%

In the News:

Discovery Group says it invested in Given Imaging "because of its transformative and disruptive technology, as well as the large untapped end-markets". However, the activist also called the company chronically undervalued and called for the board to buy \$50 million of shares and sell up in order to reach \$26-30 per share.

Starboard Value failed to prevent the merger of Smithfield Foods with a Chinese buyer. Starboard's profits may still be considerable. The firm started buying shares in April at \$25.42. Shuanghui paid \$34 per share.

Carl Icahn withdrew his opposition to Dell Inc's leveraged buyout after a Delaware Court approved changes to the voting standard. Only 51% of non-management shareholders supported the deal. Icahn roiled against the 'divine rights of boards' in a Wall Street Journal Op-Ed.

Cevian Capital gained board representation at Nordic companies Metso and Tieto, before being rumoured to be lobbying for the UK's G4S to be broken-up.

Barrick Gold attracted attention after **Two Fish Management** called for the company to be broken up.

Campaign to watch...

Going, going, gone... Third Point on offensive

September was barely out when Third Point LLC's Dan Loeb declared war on Sotheby's Chairman and CEO, Bill Ruprecht. In a letter, Loeb spared few criticisms, saying that while he made an "able steward", the company needed to play "offense".

Loeb now expects to be offered a seat on the board, with his pitch being that he will make the recruitment of new independent directors and a CEO "from either within or outside the company" a priority. So keen is he that he has already been tapping potential candidates (with two earmarked), and wants to bring internal candidates into the process. Loeb has form in this area. Last July he was instrumental in recruiting Marissa Mayer as CEO of Yahoo.

Loeb is critical of Sotheby's aggressive closing down of its margins. The company argues that Christie's has been stealing a march by offering cheaper services, but Loeb wants to see Sotheby's "competing based on the quality of its service, its expertise, and ability to generate the highest possible price for its customer." It is thought that Marcato Capital Management would prefer to see dividends or share buybacks to a major reorganisation.

Loeb goes on to mock management's scant stockholding and perks, saying these invoke "the long-gone era of imperial CEOs". Jokingly, Loeb says he knows Sotheby's is a luxury brand, but "this does not entitle senior management to live a life of luxury at the expense of shareholders."

Sotheby's also has activists Trian Fund Management and Marcato Capital Management on its share register. The company has tried to pre-empt a public campaign by announcing the sale of its New York headquarters and a strategic review (due to publish recommendations next year). Marcato's Richard McGuire says he has enjoyed "good dialogue" with the management team.

However, dialogue has not been sufficient for Third Point, and it remains to be seen whether the other activists will fall behind Loeb or the board. Sotheby's itself has limited options. It has already allowed the activists to acquire 18% of the shares, and a poison pill might alienate, rather than comfort other investors. The timeframe of its strategic review was always likely to be too long for the activists to wait, and increases the likelihood that the company will allow at least one activist nominee onto the board.

13D Digest September

Activist 13D's	11	↑
Activist 13D/A's	48	↓
Total Activist funding	\$36,550,756	↑

Activist Insight...

Activist Insight aims to provide the most comprehensive global information source on activist investment including news, profiles of activist firms, performance benchmarks and more.



Activist Insight