

Schulte Roth&Zabel

2018

Shareholder Activism Insight

A Schulte Roth & Zabel report in association with Activist Insight and Okapi Partners

Schulte Roth&Zabel



Activist Insight



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– THE HEDGE FUND JOURNAL

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

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– ACTIVIST INSIGHT AND
THE WALL STREET JOURNAL

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Methodology

In August 2018, Schulte Roth & Zabel commissioned Activist Insight to interview 36 respondents from different activist firms. The survey sample consisted of economic activist funds that have engaged almost 300 companies since 2013, including some of the largest and most high-profile situations. Respondents were asked about their experience with shareholder activism in their respective regions and their expectations for activity in the next 12 months. All respondents are anonymous and results are presented in the aggregate.

Schulte Roth & Zabel foreword

Marc Weingarten, Ele Klein, Aneliya Crawford and Brandon Gold

Schulte Roth & Zabel is pleased to present the 2018 edition of *Shareholder Activism Insight*, a survey of activists' views published in association with Activist Insight and Okapi Partners.

In late 2017, after the most expensive and largest market cap activist contest in history, many questioned whether Procter & Gamble's initial statement that Trian Partners had lost its campaign to elect founder Nelson Peltz to its board signified an end to the rising tide of activist investing. Procter & Gamble's subsequent appointment of Mr. Peltz to its board effectively confirmed the opposite: that activism is here to stay and that any company can be vulnerable. Throughout 2017 and 2018, activism has continued its upward trajectory, with at least 610 activist campaigns in the first half of 2018 (an almost 10 percent increase since 2017).

Activist funds have continued to find success in their campaigns, as almost all types of stakeholders have become more accepting of activists and institutional investors seem to universally agree that shareholders should have a voice in the boardroom.

While many companies are reacting to activists' prospects of success by engaging in good faith with them and adopting their suggestions when appropriate, other companies, unfortunately, have been busy at work trying to ensure that shareholders never have the chance to support an activist in a proxy contest. Some targets with poor prospects at the polls have adopted unreasonable advance notice bylaws, rejected shareholder notices by nitpicking immaterial deficiencies, and surreptitiously lobbied banking regulators, insurance commissioners and even the Committee on Foreign Investment in the United States (CFIUS) to stymie activists via regulatory intervention, typically premised on some erroneous claim regarding activist "control" of a target. While some of these tactics have allowed companies to temporarily put off judgment by shareholders, these tactics can easily backfire in the long run.

One of the more novel, and increasingly prominent, contributors to the growth in the number of campaigns and funds has been activists' pursuit of activism outside of the traditional focus on corporate financial performance. In the view of some funds, social activism is another lever to help portfolio companies deliver long-term value.

As more allocators have shown an interest in ESG (environmental, social and governance) focused funds, traditional activists such as JANA and ValueAct Capital are launching new funds focused on ESG activism. As activists seek additional opportunities to deploy and raise capital, one can expect more activists to enter the fray.

Along with seeing new types of activism, we are increasingly witnessing more traditional investor groups dipping their toes into activism. In our 2016 survey, an overwhelming majority of respondents did not expect mutual funds and index funds to pursue activist engagements. Against expectations, these traditional asset managers have stepped up their engagement with companies, with numerous asset managers going as far as making their gripes with companies public. We can only expect to see mutual funds and index funds continue to become more vocal in the coming months.

With increased support for activists amongst stakeholders, activists' willingness to engage in new types of activism, and the adoption of activist tactics by traditional asset managers, one can expect activism to continue to thrive both in the headlines and behind the scenes.

Schulte Roth & Zabel



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Activist Insight foreword

Activism is at an inflection point. The hot money that poured into funds, boosting assets under management and enabling some of the largest activist campaigns, is gone or going. Valuations in the U.S. have continued to soar, especially for the bigger, more stable companies that make attractive targets. Scrutiny of demands is at an all-time high; although it has become widely admitted that activism is in general a force for good, excessive short-termism or ill-considered recommendations are quickly condemned.

That is not to say that the picture is entirely bleak. The slow tightening of monetary policy and record levels of M&A have provided options for strategic alternatives at target companies; global attention to corporate governance has made directors less insulated; and a recovery in commodity prices has infused institutional investors with new enthusiasm for holding underperforming management teams to account. Although 31% of respondents think interest rate increases will have a negative impact on activism next year, a quarter think the opposite.

As we approach the beginning of the 2019 proxy season, it is hard to say whether the headline action will be at U.S. large caps, as in 2017, or mostly overseas, as it has been this year. As activists begin preparing for proxy season, the U.K. has been a target for ValueAct Capital Partners and possibly Trian Partners. Japan is still attracting U.S. investment firms and pushing corporate governance reforms. With overall 2018 activity approaching record levels, it seems unlikely that next year will be quiet.

Against this background, much is changing about the way activists do business and our survey bears out many of the axioms that have been making the rounds over the two years since we last produced this report for Schulte Roth & Zabel.

First, activists remain hungry for capital – 72% of respondents are raising “some” or “a lot” of capital. But nearly half are forced to use co-investment vehicles frequently, a strategy that can have plenty of benefits for funds but can also allow allocators to be more picky.

Second, operational and environmental and social activism are expected to increase. With both JANA Partners and ValueAct launching impact investing funds, activism now takes in the “E” and “S” in “ESG,” as well as governance. Operational activism, meanwhile, appeals to long-only institutional investors. And although tax reform has many observers, including respondents to

this survey expecting more balance sheet activism, it has been subtler in recent times lest it be viewed as short-termism.

Third, activists are seeking out new markets and taking on companies where campaigns would previously have been considered unthinkable. Besides the U.S., Europe and Asia were cited in our survey as the two regions where the majority of activists anticipate “a lot” of opportunity (even if the most respondents are actually looking at Canada right now). In the U.S., a large number of activists consider retail investors to have become more welcoming, unlocking targets such as Procter & Gamble and Automatic Data Processing – two of 2017’s big proxy fights.

This has been a busy year for Activist Insight and we have been working hard to make sure we have all of the bases covered. As activism has expanded around the world, we have put extra effort into ensuring we are covering not just the busiest, but all active markets. Our coverage runs the gamut from hostile M&A arbitrage to shareholder proposals, and we are expanding our predictive efforts through Activist Insight Vulnerability.

Among other things, we have launched Activist Insight Governance, a tool for analyzing the boards and bylaws of U.S. companies, and The Activist Insight Podcast, hosted by my colleague Elana Duré. In keeping with activism’s global advance, we have expanded our teams in London and New York. Even if you are not a subscriber, you may read our twice weekly free newsletters, “Activism this week” and “What’s new in activism,” which can be subscribed to on our website.

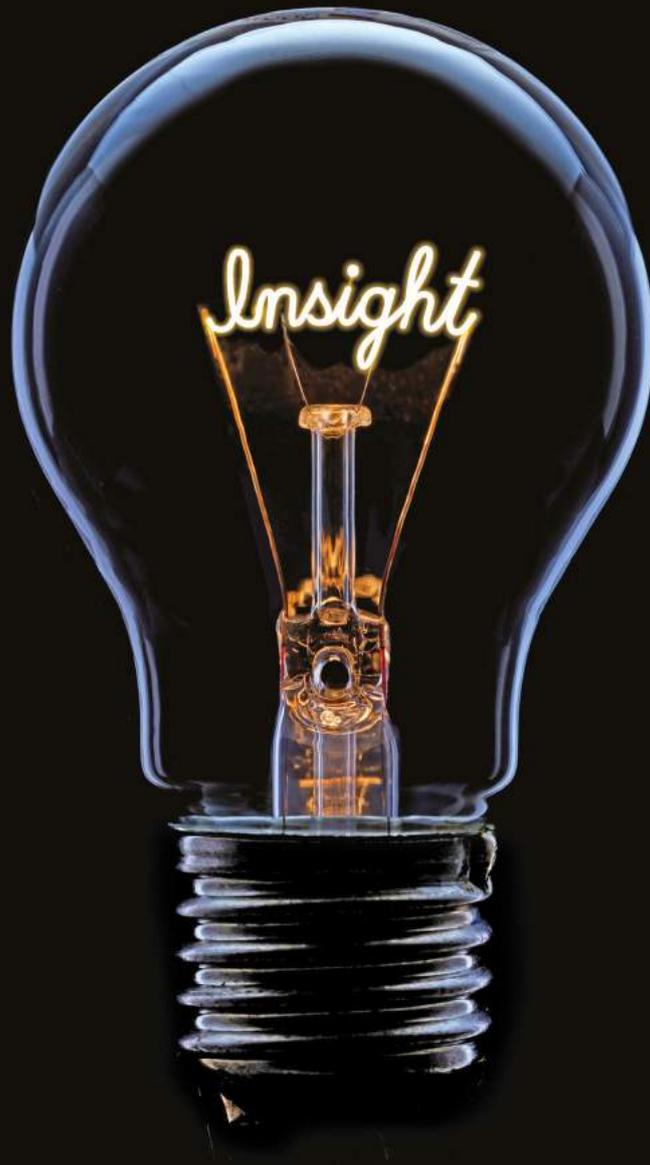
It was a pleasure working with Schulte Roth & Zabel and Okapi Partners to once again produce this report and we thank them for their continued support.



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Room to grow

An interview with Bruce Goldfarb, president and CEO of Okapi Partners.

Activists do not seem to believe that the U.S. is overcrowded with activists. Can activism continue to grow?

There's no question that activist investment strategies, which represent a tiny fraction of the overall investment and asset management universe, have room to grow. Fundamentally, activists are value investors and look for underperforming companies that can be improved.

In fact, a number of traditional investment management firms are becoming more activist-like by publicly demanding changes in management and boards of companies in which they have positions. It remains to be seen whether such firms will seek to replace directors through proxy contests and we wouldn't be surprised if more traditional investment managers consider using the proxy voting system to force change at their investments.

For now, capital continues to be raised for activist strategies and more allocators of capital are becoming comfortable with it as an asset class. If you take the 20,000 foot view, we think shareholder activism is really in its early stages.

How has increased engagement by institutional investors of their portfolio companies affected activists?

As traditional investment managers become more engaged with the companies they own, activist investors will have more opportunities to enact change. As we've worked on campaigns over the last year or so, we've seen which issues concern different institutional investors and how and when they decide to indicate their support for activists. That's given us some good insight into how complex the landscape has become as shareholders adjust their priorities with regards to ESG and other issues.

Predicting how a large investor might vote based on prior votes is becoming more difficult and activists need to conduct a careful analysis of a potential target's shareholder base to effectively map out a strategy. Companies also need to monitor their shareholder base constantly to make sure they understand who owns their shares.

Activists seem to believe retail investors are becoming more susceptible to their messages. Is this the case?

As activists continue to gain a level of legitimacy in the market and design more effective ways to reach

shareholders with their message, retail participation in the voting process should increase. The campaigns at Arconic, DuPont and Procter & Gamble were recent cases where retail participation had a significant effect on the outcome of the vote. In many cases, employees make up a large portion of retail shareholders and we find that they are often highly-engaged in the voting process. Still, retail voter apathy is one of the most important challenges we have to overcome when working on a campaign. We find that many retail shareholders will vote their shares, but they require direct and indirect outreach, which takes time and resources.

Do you anticipate more activists branching out into environmental and social issues?

Environmental and social issues are increasingly on the radar of both activists and large institutional investors. There's been an evolution in thinking over the past few years where a company's social and environmental profile is thought of as a determinant of its worth in the market and its overall profitability.

From what we have experienced throughout the year, environmental and social issues are at the forefront of how investors evaluate the future performance of a company. In their overall diligence, activist investors are noting where a company is deficient in these areas and you can bet that these deficiencies will be a target of their campaigns. Companies with strong shareholder communications and robust ESG policies will be able to better fend off an activist if they find one knocking on the door.



Bruce Goldfarb

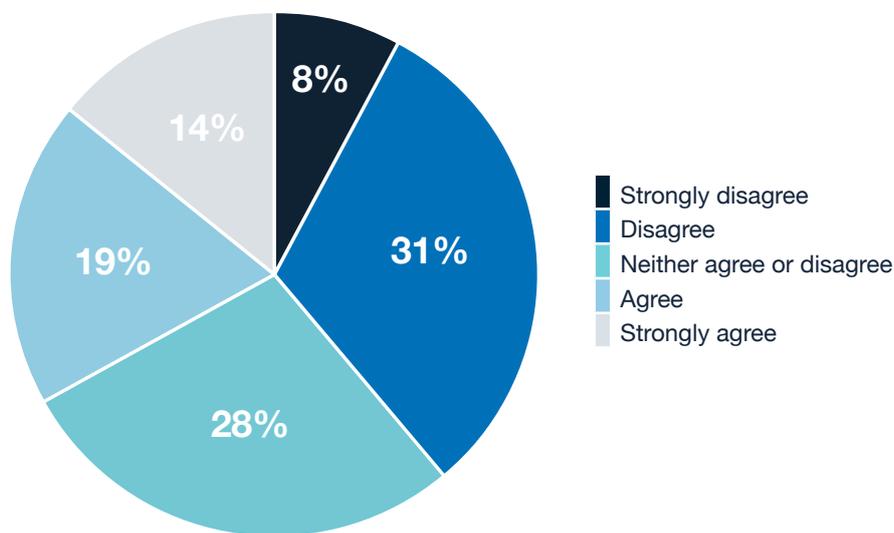
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Can we go on like this?

After enduring a first down year in recent memory in 2017, the number of campaigns has sprung back in 2018. Although U.S. activists are showing a greater inclination to look as far as Asia and Europe for investment opportunities, newcomers to the space and occasional activists have been more prolific. A third of respondents see that as a problem, agreeing that overcrowding is limiting the number of opportunities. But fully 39% disagree and, what's more, the numbers have not shifted since the 2016 edition of the survey.

Activism is becoming crowded in the U.S. and targets are becoming increasingly hard to find.



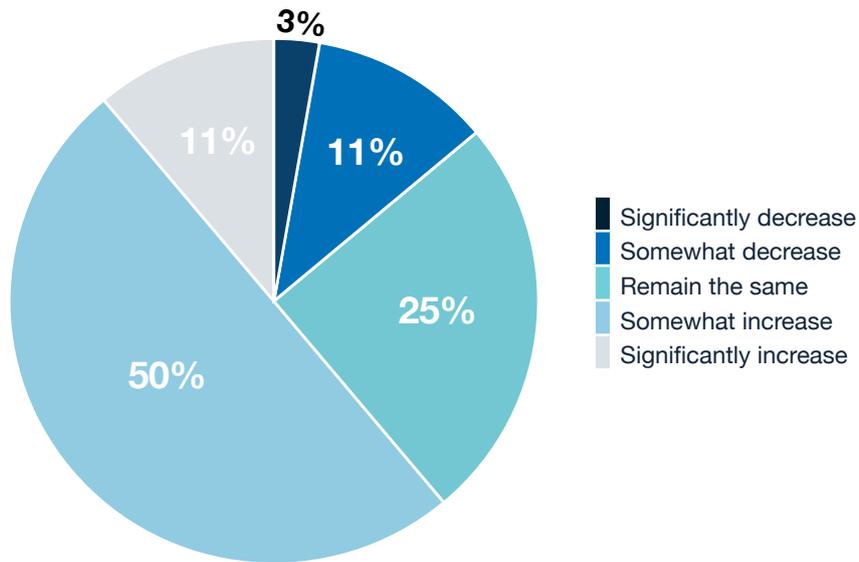
How many activist campaigns do you expect to be involved in over the next 12 months?



“With an acceleration in competition and strong markets in the United States, many activists are increasingly looking to Europe and Asia.”

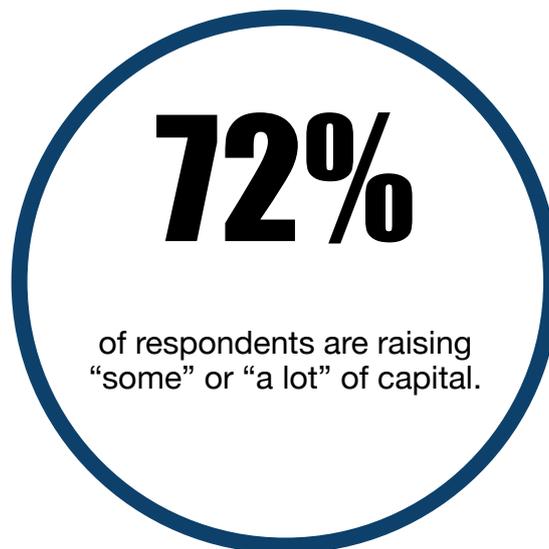
- Marc Weingarten, Schulte Roth & Zabel

Capital deployed in shareholder activism has grown significantly over the last few years. Relative to the pace of current growth, how do you anticipate the assets allocated to activist strategies will change over the next 12 months?



A key factor behind the growth of activism was the major increase in assets under management between 2010 and 2015. Asset growth appears to have plateaued since that high point, but respondents' ambitions for capital-raising and expectations for the industry as a whole show an undimmed appetite. 47% of respondents said that they expected to use co-investment vehicles in more than a quarter of their activist investments.

For the capital you manage, what are your expectations for the amount of new capital raised over the next 12 months?

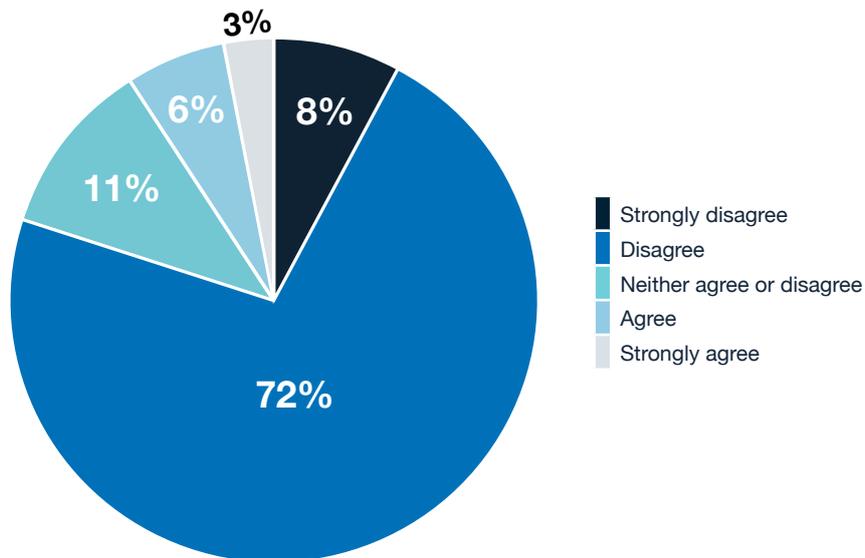


“Activism remains an attractive asset class and, particularly with the increase in co-invest vehicles, more capital will be deployed in campaigns.”

– *Ele Klein, Schulte Roth & Zabel*

An existential threat?

Increased engagement by institutional investors with portfolio companies will decrease the role of activist investors.

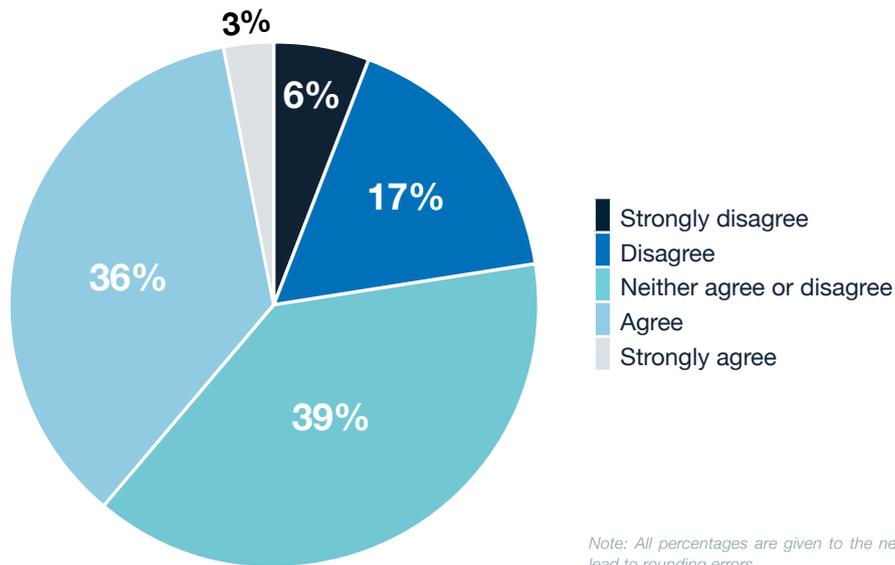


Much has been made of the impact that increased engagement between institutional investors and portfolio companies will have on activism. At least one institutional investor has said it will not issue “requests for activists,” while others have sought to adopt their own activist strategies. Yet fewer than 20% of respondents see institutional investors as a direct replacement for activists, possibly because institutions are strapped for resources or are unwilling to adopt hard-line positions.

“Increased engagement by institutional investors and other shareholders only bolsters the case for activists — often as catalysts or as captains on the field — and we expect to see more overall activity as a result.”

- Bruce Goldfarb, Okapi Partners

Activists will be forced to work together to create change in the future.



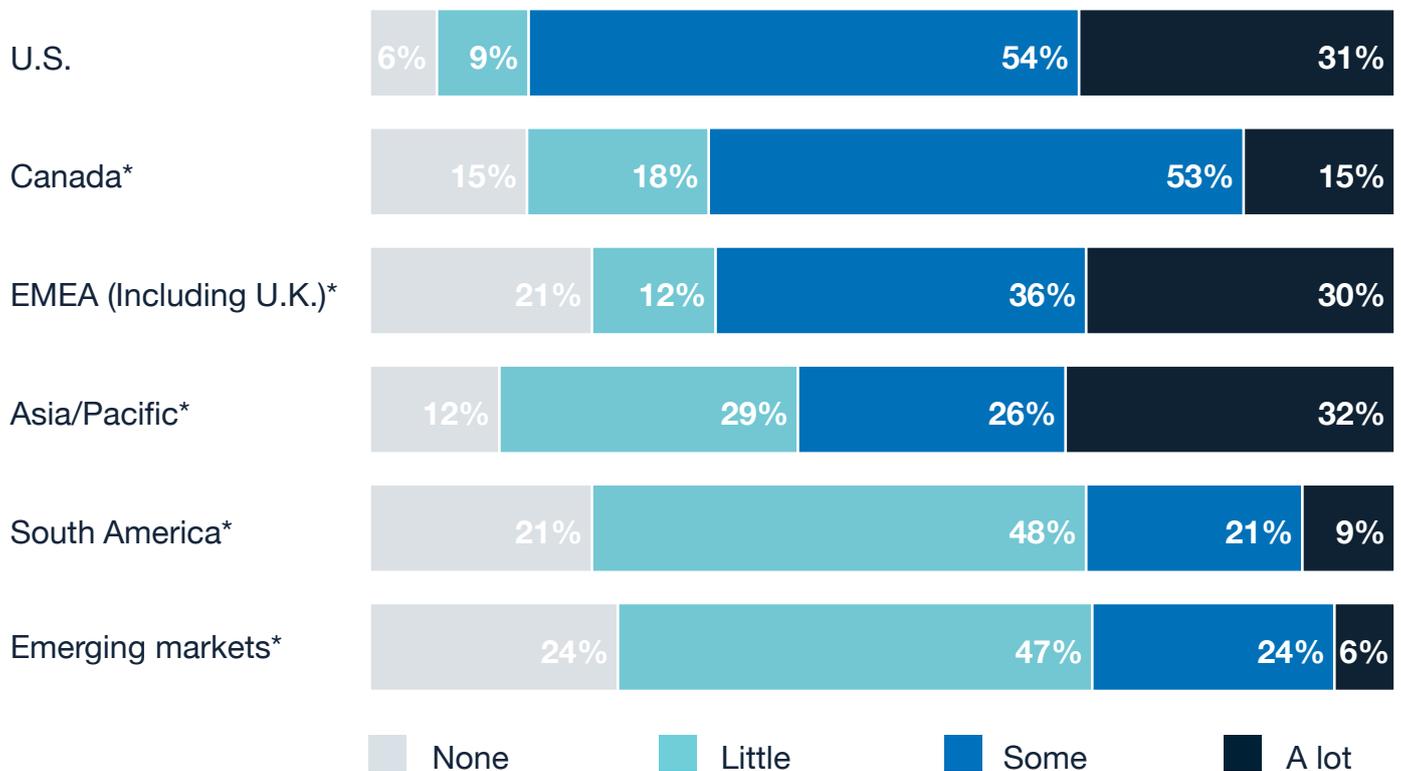
Activist investors have been known to target the same companies both at the same time and years apart. At times, they have also formed investment groups to press for the same aims, accepting the regulatory obligations that come with this for the added impact. Notably, 36% of respondents felt activists would be forced to work together to create change in the future, perhaps reflecting the need to amass larger stakes for deep-rooted operational or structural changes.

“While the major players will likely continue to go it alone, other activists may work together more often to increase their impact.”

- Marc Weingarten, Schulte Roth & Zabel

It's a small world

For shareholder activism, how much opportunity do you anticipate in the following regions?



* All percentages are given to the nearest whole number, which may lead to rounding errors.

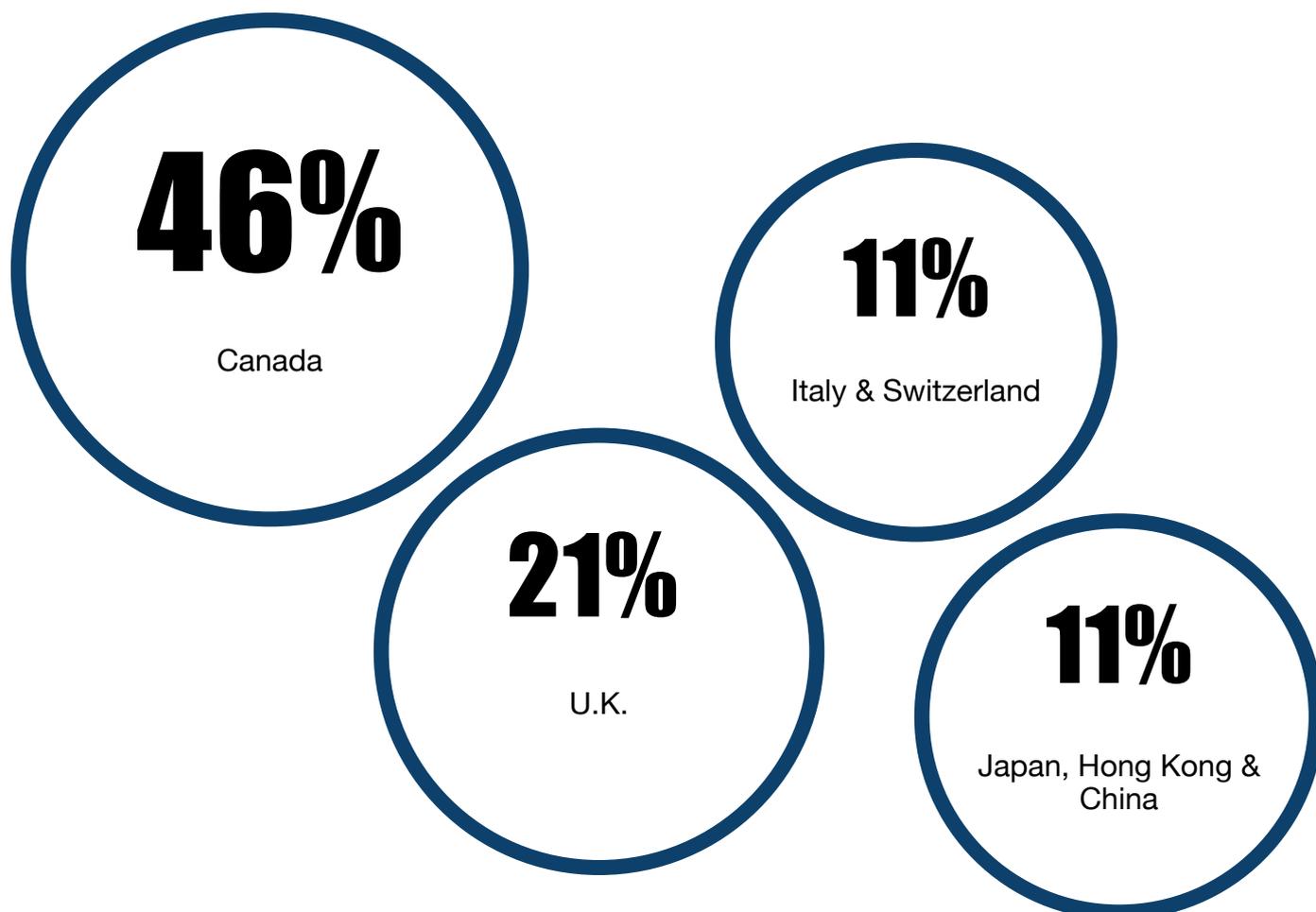
Our survey found that the U.S. remains the most attractive market for activists. Close behind are Canada and EMEA – the latter of which has a higher number of enthusiastic fans but slightly fewer overall. Asia/Pacific stood out too – fewer respondents said they saw no opportunity than for any region other than the U.S., while more respondents selected “a lot” of opportunities than any other category.

“While enthusiasm about the European and Asian markets continues to grow, many activists are still finding attractive value opportunities in the United States.”

- Aneliya Crawford, Schulte Roth & Zabel

For the capital you manage, please indicate any non-U.S. jurisdictions you are currently considering for potential activist investments.

Reflecting a greater accessibility and shareholder-friendly regulations, Canada is currently the leading non-U.S. market under consideration by our respondents, with nearly half considering investing there this year. Despite Brexit, the U.K. follows with 21% of respondents watching its companies. In the rest of Europe, Italy and Switzerland stand out. In Asia, where Elliott Management and ValueAct Capital Partners are active, Japan, Hong Kong and China trump South Korea.

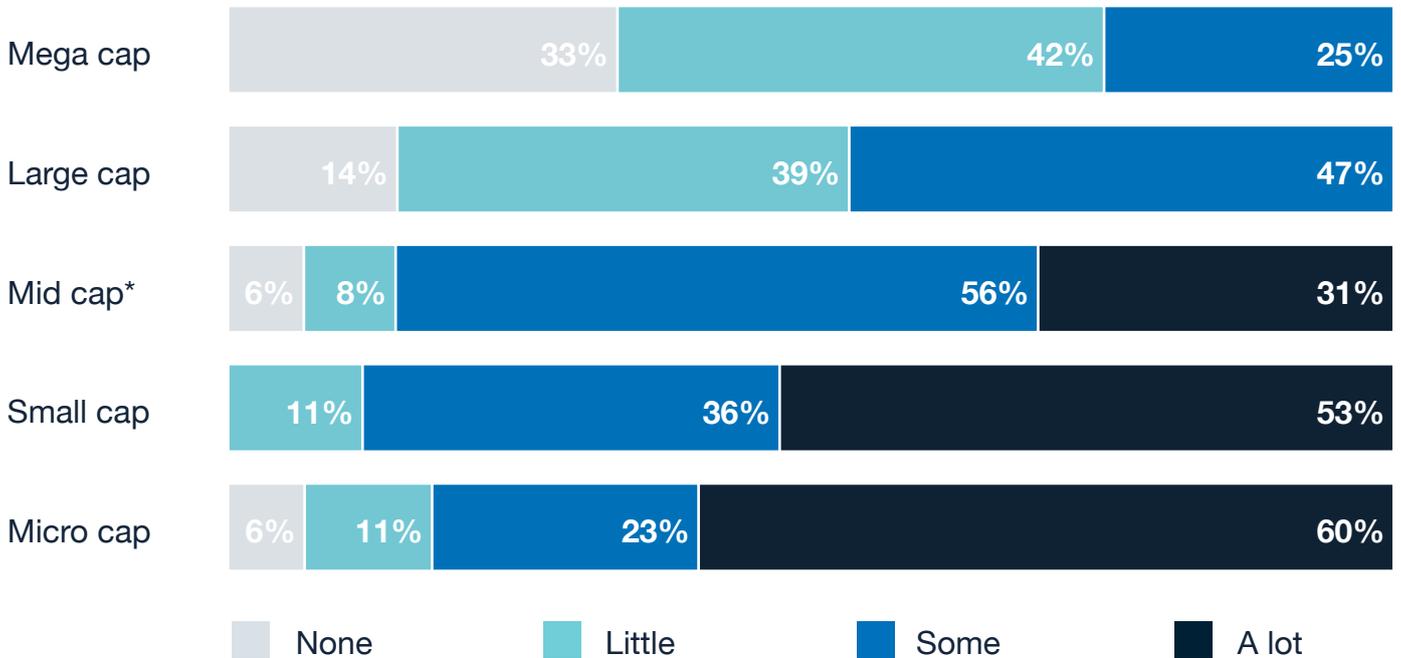


“Whilst the impact of Brexit on business remains unclear, it also creates an opportunity which – considering supportive U.K. corporate governance rules and shareholder rights – has meant the United Kingdom is still a natural focus point for many.”

- Jim McNally, Schulte Roth & Zabel

Where's the action?

For shareholder activism, how much opportunity do you anticipate in the following market-cap ranges?



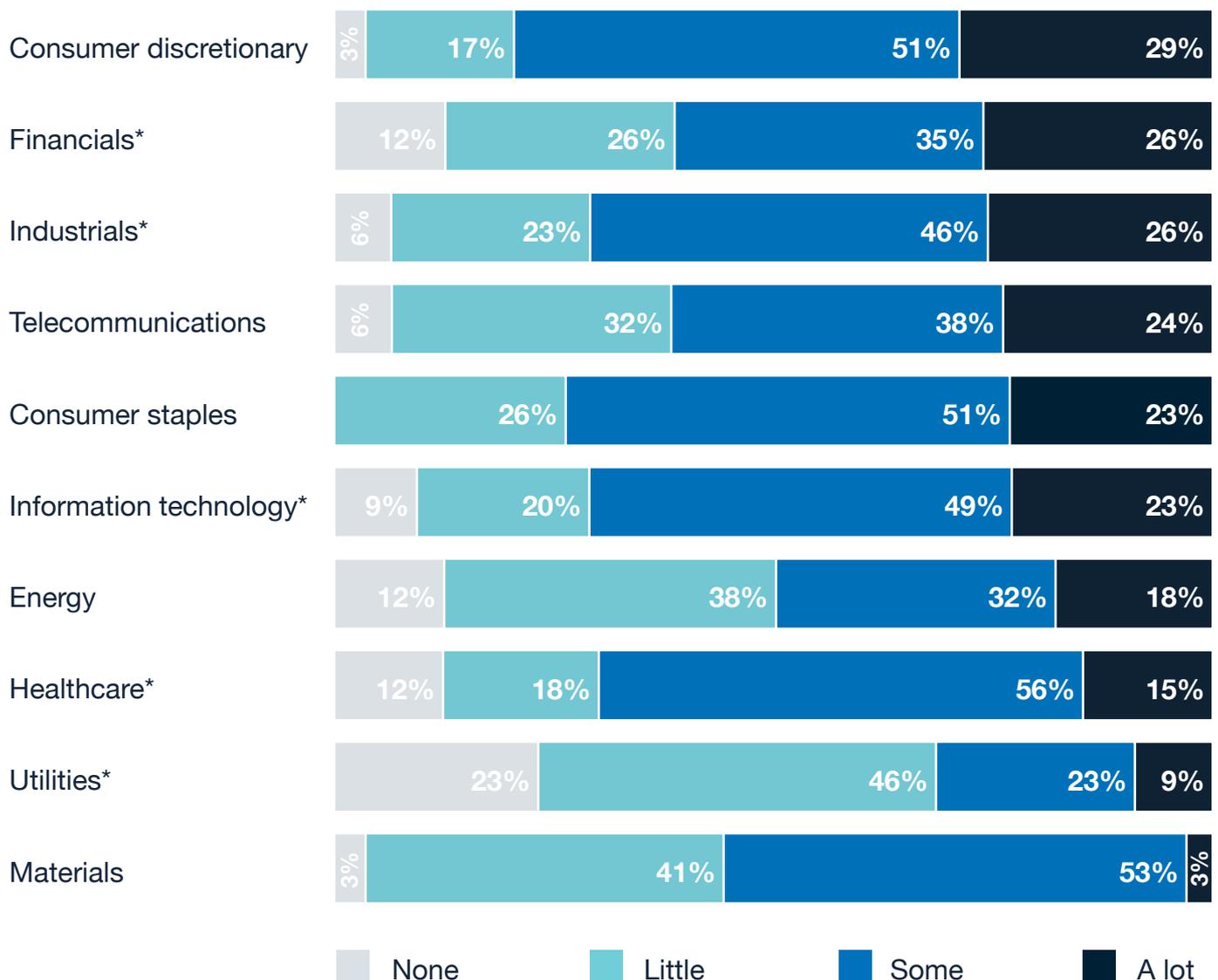
* All percentages are given to the nearest whole number, which may lead to rounding errors.

While mega-cap campaigns attract the most attention, activists see the number of opportunities shrinking as company size increases. With several activists needing to invest large sums to guarantee meaningful returns and new ground broken in 2017 through Triun Partners' successful proxy contest at Procter & Gamble – the largest company to face a solicitation thus far – there is unlikely to be a complete dearth of campaigns however.

“We see valuations as much more influenced by market cap than sector.”

- Survey respondent

For shareholder activism, how much opportunity do you anticipate in the following sectors?



* All percentages are given to the nearest whole number, which may lead to rounding errors.

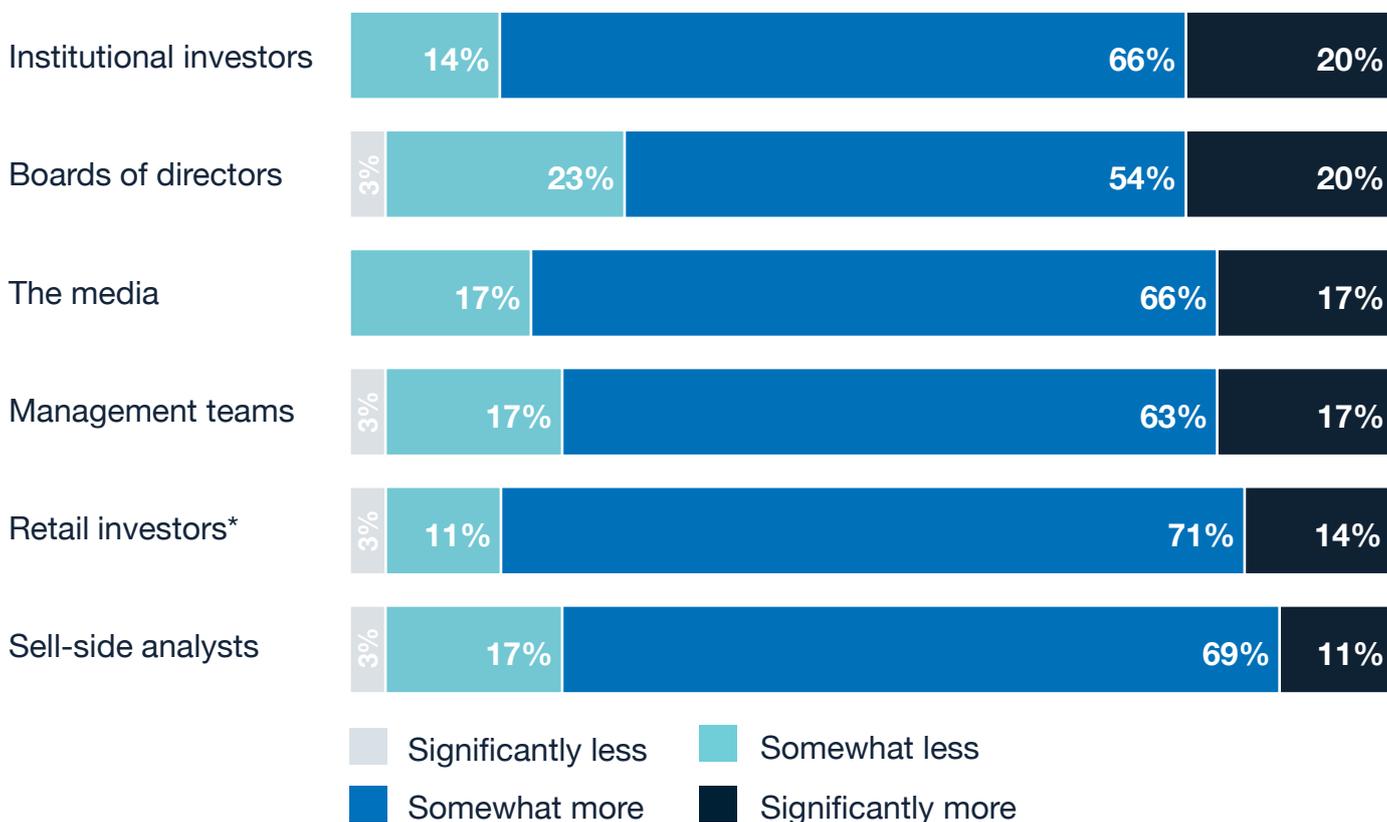
Activists have identified opportunities in a range of sectors and the outlook continues to be broad. Technology and consumer stocks, which have seen a surfeit of activity from restaurants to packaged foods, saw some of the highest anticipated levels of opportunity for our respondents. Financials and basic materials, including energy stocks, are subject to a more bifurcated approach.

“Many activists find opportunities across a broad range of sectors, with the appetite for activism spread pretty evenly among various industries.”

- Aneliya Crawford, Schulte Roth & Zabel

Stakeholder democracy

Compared to previous years, how accepting have the following stakeholders become of activist investors in the past 12 months?



* All percentages are given to the nearest whole number, which may lead to rounding errors.

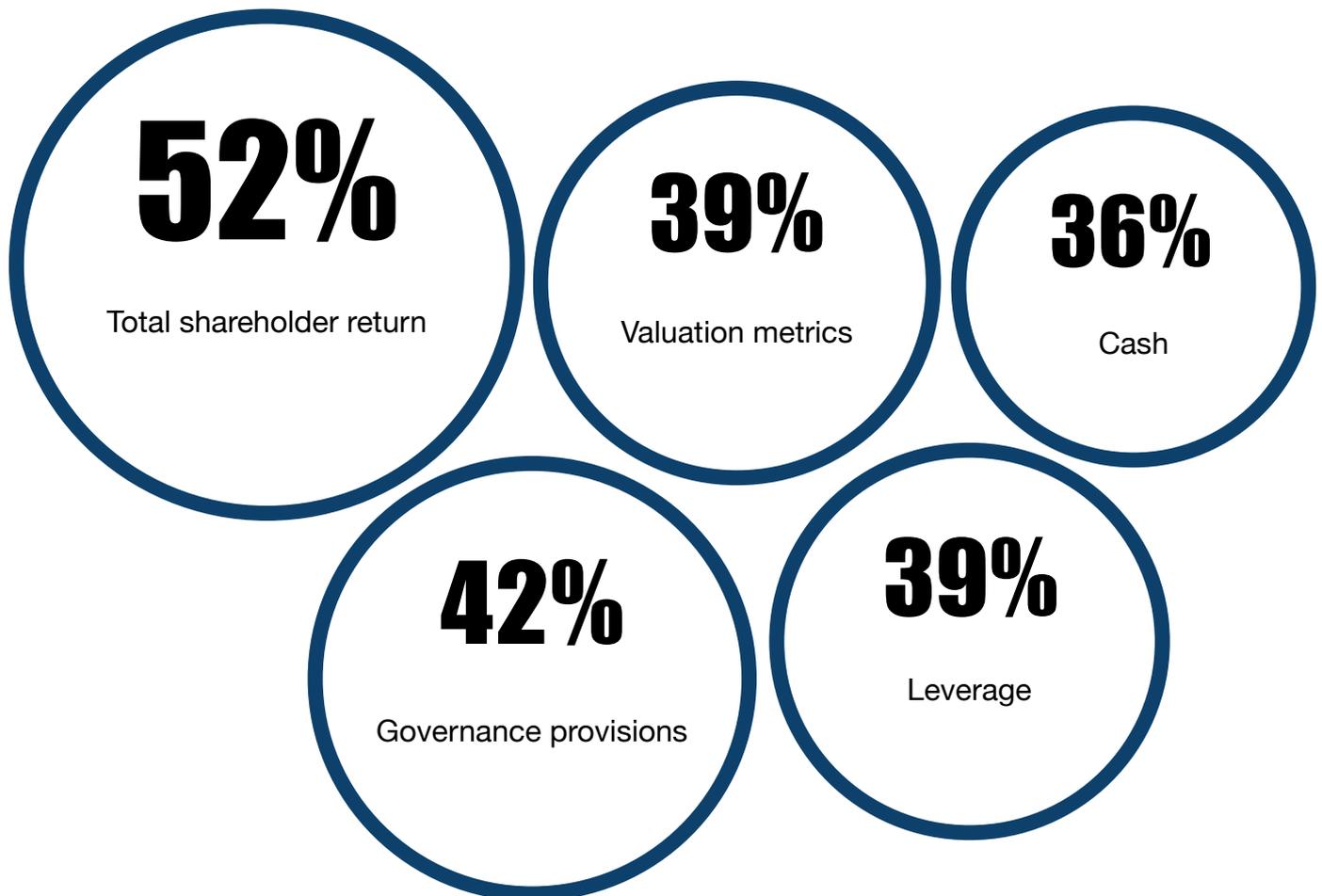
A large retail shareholder base is no longer a deterrent for activists, as several companies discovered in 2017. That may be because their historical antipathy to activism is waning. More respondents to our survey felt mom-and-pop shareholders have become more accepting of activism than any other group, although institutional investors, management teams and boards have made the biggest strides in working with dissident shareholders.

“Shareholder activism, in all forms, is becoming more mainstream and corporate boards and management teams need to increase their proactive engagement with shareholders in order to make sure they stay ahead of possible activism.”

- Bruce Goldfarb, Okapi Partners

Screen time

Have any of the following screening options become more important to you over the past 12 months? Select all that apply.



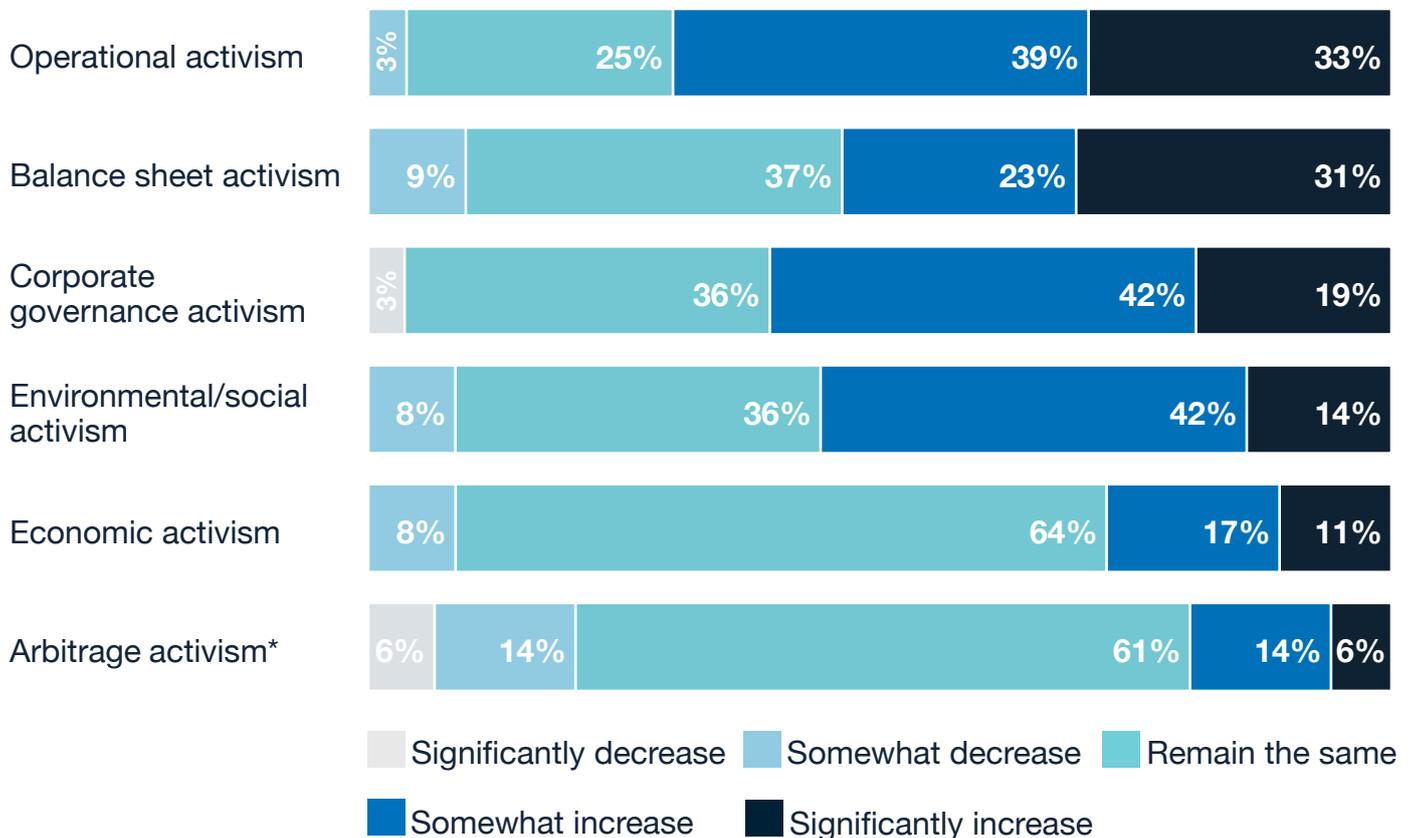
With the continued strength of equity markets, around one-third of respondents cited cash, leverage and valuation ratios as increasingly important screening tools for their next campaigns. Less than 26% said margins have become increasingly important, behind revenue and profit trends - suggesting that business strength remains a key consideration. Poor stock price performance continues to be the main staple of vulnerability to activism, with an apparent increase in the importance of governance metrics compared to our 2016 survey.

“If the long bull market is adding to concerns that some stocks may be overvalued, this merely reinforces the pressure on laggards and companies that have yet to get their corporate governance in order.”

- Josh Black, *Activist Insight*

Margin call

For the below types of shareholder activism, what are your expectations for the amount of each type over the next 12 months?



* All percentages are given to the nearest whole number, which may lead to rounding errors.

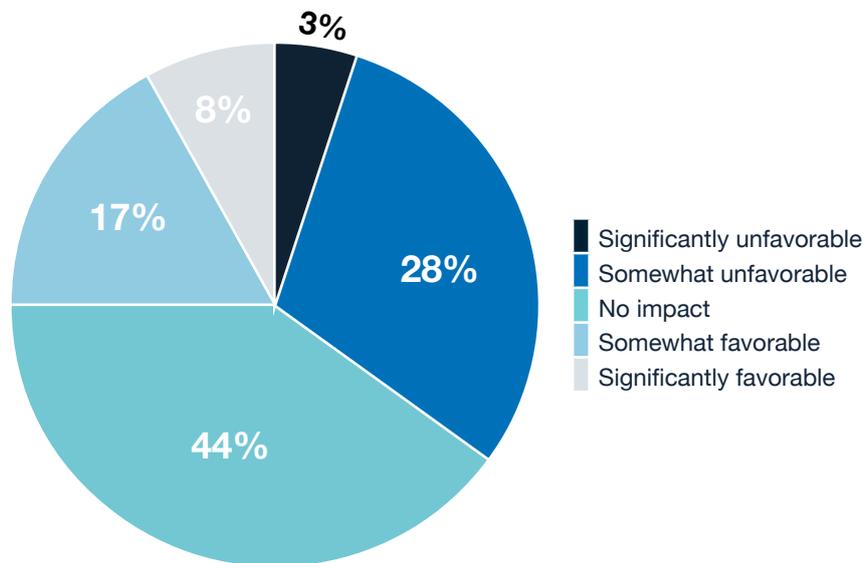
Despite a strong market for M&A, most respondents expected arbitrage and economic activism - involving structural changes and breakups - to remain at broadly similar levels. Activists surveyed believed operational and balance sheet activism would take the biggest leaps forward, while governance and environmental or social activism - popular topics for institutional investors and allocators - would somewhat increase following tentative steps into impact investing for the likes of JANA Partners and ValueAct Capital Partners and proxy fights in which board diversity have played an atypically large role.

“Investors are focused on economic fundamentals and are taking steps to protect their capital at companies that are underperforming or otherwise not maximizing their potential.”

- Ele Klein, Schulte Roth & Zabel

Rising interest

In general, how will increasing interest rates impact shareholder activism over the next 12 months?



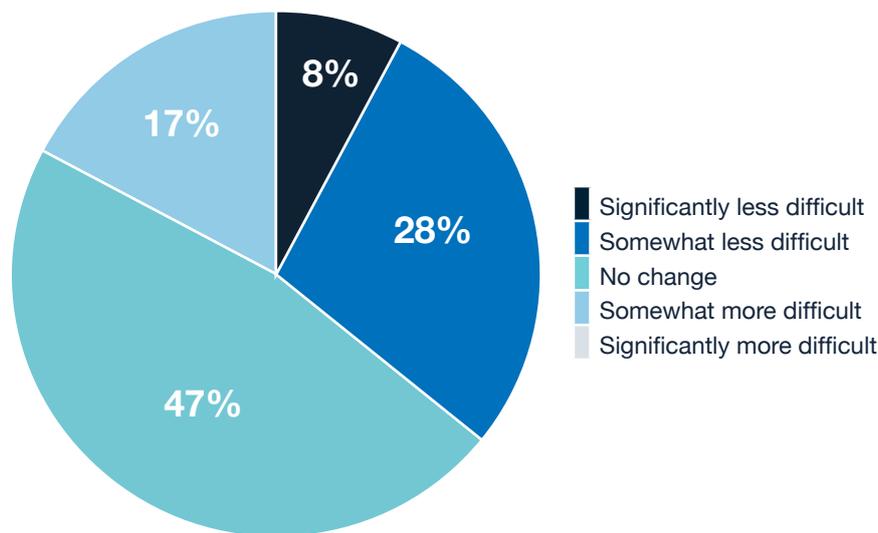
Rising interest rates typically have a negative effect on stocks by increasing the attractiveness of other assets and making leveraged strategies such as buybacks and M&A more difficult. Some 31% of respondents think tightening over the next 12 months will have a negative impact on activism, while a quarter think that it may actually help activists. By far the largest group, however, sees no impact from rising rates.

“While the economy has an impact on activism levels, rising rates are unlikely to turn off the taps.”

- Josh Black, *Activist Insight*

Settling down

Compared to previous years, how difficult is it currently for activist investors to reach settlements with management teams?



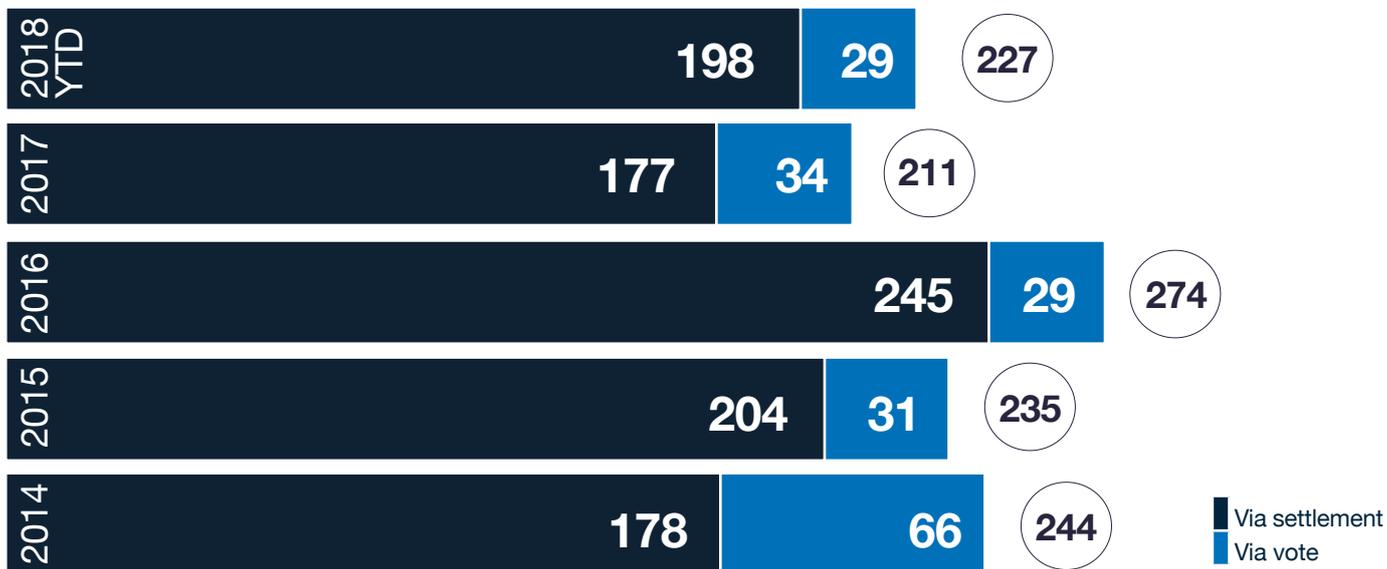
Settlements ebb and flow, depending on numerous factors. In 2016, only 3% of respondents said it had become more difficult to reach settlement agreements. Following a rash of proxy fights at especially large companies and criticism of hasty settlements by institutional investors, the number has risen to 17%. Yet for the overwhelming majority, there has been either no change or settlements are easier to come by.

“While the overall settlement trend continues, aggressive defensive tactics have led to more companies seeking to litigate instead of proactively trying to settle and address shareholder concerns, thereby delaying some settlements and making them harder to achieve.”

- Michael Swartz, Schulte Roth & Zabel

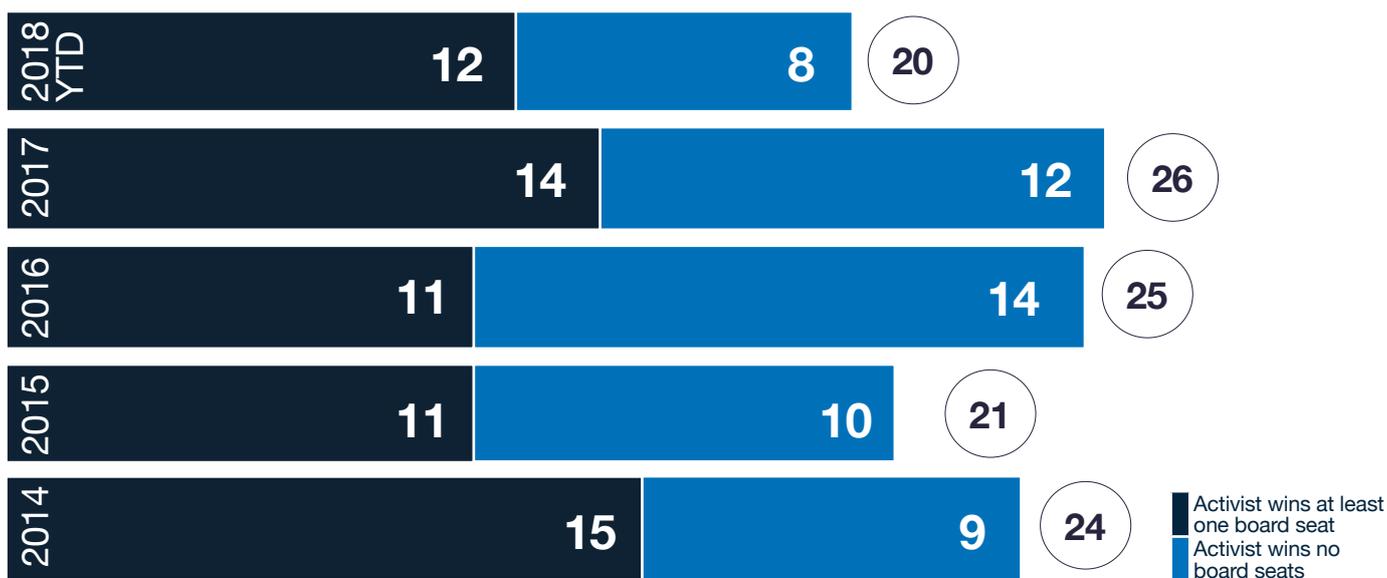
Board data

Board seats gained



Total number of board seats gained by activists at U.S.-headquartered companies via means of settlement or shareholder vote.
 All data as of September 15, 2018.

Proxy contest vote outcomes



Total number of proxy contests that went to a vote at U.S.-headquartered companies and eventual outcome.
 All data as of September 15, 2018.



Schulte Roth & Zabel

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Widely regarded as the dominant global law firm for activist investing, SRZ brings a sophisticated knowledge of market practices and unparalleled expertise in all areas related to activist investing. SRZ has more than 30 years of experience advising clients on more than 1,000 shareholder activism matters, making us one of the most experienced advisers to activists in the world.

The only full-service law firm for activists, SRZ assists with all matters relating to activism, including campaign strategies, corporate governance, proxy rules, trading and affiliate rules, Sections 13 and 16 compliance, antitrust regulations, federal and state securities and corporate laws, tax and regulatory issues and litigation. We help our clients navigate applicable law and regulations on a global scale, and our legal team provides guidance on both the strategic and tactical level in everything ranging from running proxy contests, consent solicitations or withhold campaigns, calling special meetings or engaging in exempt solicitations and partnering with management and corporate boards to effectuate high-level changes that make an impact. Our team can also guide clients through issues related to M&A activism, spin-offs, split-offs, divestitures and buybacks, regulatory approvals, investigations and legislative hearings, corporate governance improvements and defensive and offensive litigation.

SRZ's long-standing, top-ranked activist practice has handled some of the highest profile and most hotly contested campaigns in the history of activism. Serving the world's most seasoned and prolific activists, "occasional activists" and institutional investors in campaigns ranging from mega-caps to small-caps, we help clients see a situation from every angle and develop the right strategy for both the short term and the long term.

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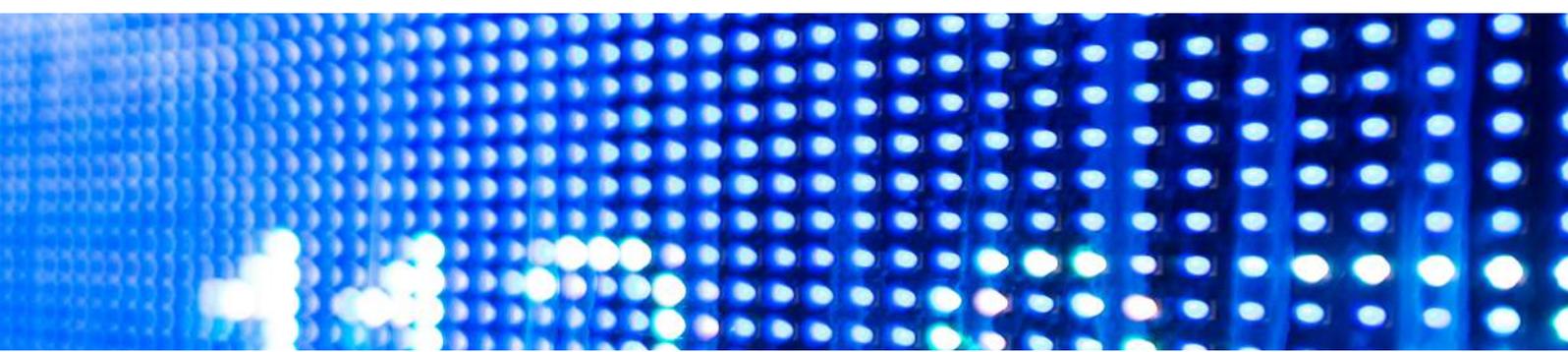
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About Activist Insight

Since 2012, Activist Insight (www.activistinsight.com) has provided its diverse range of clients with the most comprehensive information on activist investing worldwide. Regularly quoted in the financial press, Activist Insight is the trusted source for data in this evolving space. Activist Insight offers five industry-leading products: *Activist Insight Online*, *Activist Insight Shorts*, *Activist Insight Governance*, *Activist Insight Vulnerability* – a tool for identifying potential activist targets – and *Activist Insight Monthly* – the world's only magazine dedicated to activist investing.

About Okapi Partners

Founded in 2008, Okapi Partners is a strategic proxy solicitation and investor response firm providing a full range of solicitation and information agent services, as well as related consultation and advice to clients. The firm represents corporations, mutual funds, private equity firms, hedge funds and institutional investors and provides them with superior intellectual capital, industry relationships and execution capabilities. Okapi Partners was recently recognized as the top proxy solicitor by Activist Insight magazine for the second year in a row. The firm represented both issuers and activists in 26 campaigns in 2017 in what was one of Okapi's most successful years since its founding in 2008, according to Activist Insight. In 2017, Okapi Partners worked with over 100 corporate clients providing advice on proxy solicitation matters, corporate governance issues and shareholder engagement strategies.



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