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HOW NOT TO WIN BOARD SEATS

THE LONG VIEW

ACTIVISM IN NUMBERS

ACTIVISM MONTHLY

Premium

Activist Insight

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Editor's letter

Josh Black, Activist Insight

The world of activist short-selling, in which investors not only bet that a stock will fall in value but attempt to convince the market of the fact, is hardly new. Not only has the tactic been around for a while now, but it's hard even to say it has become more glamorous—Bill Ackman and David Einhorn were publicly calling out companies in the mid-2000s, just as they are today. Few of their contemporaries have joined them on any meaningful scale, and even Ackman says he may "be done with public shorts."

Nonetheless, activist short-selling may be on the rise. Data collected by Activist Insight certainly suggests that it is, with the last two years by far the busiest for these sorts of campaigns since 2010. Battles over the likes of Herbalife, Quindell and Globalstar have focused popular attention on the tactic, and short-sellers have occasionally begun to find themselves lining up in opposition to long activists who believe they can turn a business around; witness Jim Chanos' bet against Sotheby's, which has Dan Loeb on its board.

As our feature makes clear, short-selling is a risky business. Losses can be infinite, and it can be difficult even to find a meaningful amount of shares available for borrowing, especially at the micro-cap level many short-sellers call their sweet spot. Even so, much talk of frothy valuations may entice short-sellers and even influence the next generation – this year *The Economist* is holding a competition for MBA students to find a billion dollar company that could be worthless in five-years' time.

> "Short-selling is risky business. Losses can be infinite and shares for borrowing are scarce"

If this month's issue of Activism Monthly Premium has a slightly European flavor, it may have something to do with the barrage of requests we've had recently for data on this topic. So far it seems that activism in Europe this year is shaping up to be more common than last, and perhaps even as frequent as in 2012-13.

Despite talk of a US invasion, it seems the homegrown activists are actually doing the running, which may or may not lead to more European campaigns in the future. Indeed, even though we would count P. Schoenfeld Asset Management's demands at Vivendi as a 2015 campaign by a US-based activist, the facts are that the investor has been in the stock five years and runs some of its funds out of a London office. With more than a hundred activists operating UK offices, there is evidently spare capacity for activism to take place.

Elsewhere in this issue, I interview Nick Swenson, fresh from his proxy battle at Biglari Holdings. Swenson is far from the usual activist—he is also the CEO of a Minnesota-based air cargo and equipment provider. But his campaign acted as a lightning rod for shareholder discontent and was widely covered in the press.

We also touch on an important issue in the growing debate over activist investing—the support of institutional investors. BlackRock's Larry Fink last month sent a letter to all S&P 500 CEOs encouraging them to focus on their long-term value-creation plans, with emphasis on the long-term.

The next week, Frank Partnoy published an op-ed in the Wall Street Journal exploring research he conducted with C.N.V. Krishnan and Randall Thomas, showing that between 2008 and 2012, stocks responded to activist campaigns by surging an average 6% in a 21-day window surrounding the announcement of the campaign. What's more, the market's appetite for activism may be rising. In 2013, activist campaigns created an average 9% spike in the stock. "That might not sound like a lot," Partnoy says. "But reliably beating the market by 6% is like discovering the secret to winning the lottery." ■

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Activist Insight

Contents

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How not to win board seats

Cas Sydorowitz on why UK investors feel strongly about activists having a disproportionate influence.

This May, the American activist hedge fund Trian Partners is in with a strong chance of winning board seats at DuPont. If the contest goes all the way to a vote, it will be the largest company where an activist has won seats on the board by virtue of a shareholder vote. That is a remarkable thing in itself, but another significant factor is Trian's stake in the company. It owns less than 3% of DuPont's outstanding shares.

A decade ago, American activists were not considered serious unless they had a stake of more than 5% of a company's shares. Bill Ackman's Pershing Square Capital Management often likes to get closer to 10% before it starts exerting pressure on management. Today, activists can have a large impact with as little as 1% of a company's outstanding shares. Already this year, Trian has negotiated board seats at PepsiCo and BNY Mellon, where its positions are below 3%.

These are big companies, however, and Trian's positions represent significant 'skin in the game.' At smaller companies, owning less than 5% of the outstanding shares is more parlous. Activists can get around this by teaming up, to command slightly more votes, or by offering up good, independent candidates and being prepared to settle. According to Activist Insight, the smallest shareholder group to win board representation in an actual vote owned slightly under 2% of The Pantry. But that is exceptional.

Activist Insight data show barely any activist campaigns in the UK where the dissident owned less than 10% of the company's shares ended with the dissident winning board seats. Indeed, three fights in the UK earlier this year saw activists with stakes of at least 10% (and sometimes considerably more) fail to get any representation on the board: Petroceltic vs Worldview (where the activist owned 29%), Petropavlovsk vs Sapinda (10%) and Electra Private Equity vs Sherborne (26%). In the US since the beginning of 2014, by contrast, more than nine in ten activist campaigns where an activist owned less than 10% of the company's shares were either successful or ended in the company making board changes as part of a settlement agreement.

> "UK investors often feel strongly that activists should have board seats proportionate to their equity holdings"

An explanation may lie in the concept of proportionality. UK investors often feel strongly about activists having a level of board representation proportionate to their equity holding. And while many UK companies now have significant US shareholders, the proportion of UK institutions to US institutions remains high. That makes it quite challenging for a shareholder to demand a majority or significant share of the board seats when they only have 10% of the equity.

Activists have not been scared to request board seats at large UK companies when they have small stakes in the company. Some have even run solicitations or proxy fights, and with a single proxy card issued by the company, this tactic should be easier than in the US. Yet the fact remains that fewer activists opt to wage proxy fights while owning less than 10% of a company's shares than in the US, and when they do they are more often disappointed than not. As US investors have changed their perspective over the last four or five years, can we expect UK shareholders looking for greater returns to support an activist's outweighted demands? Other US activist tactics are making their way across the Atlantic, will this be the next one to make a splash? ■

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

Activist Insight

The long view

Larry Fink is arguably the most important shareholder in America. So when he speaks, CEOs listen.

With $4.8 trillion under management, BlackRock is the activist investor every executive should fear. So much so, in fact, that its CEO is now looking to scare all the others out of the ring.

In a widely reported letter to the CEOs of America's 500 largest companies, Larry Fink called time on companies' short-term bias, on which he believes activist investors have been a key influence. "The effects of the short-termist phenomenon are troubling both to those seeking to save for long-term goals such as retirement and for our broader economy," he argued, in comments that had JANA Partners' Barry Rosenstein scrambling to tell the New York Times that the BlackRock man had himself said he was not "anti-activist."

Against short-termism

"There is nothing inherently wrong with returning capital to shareholders in a measured fashion, as part of a broader growth strategy," Fink wrote in the letter. "[I]ndeed, it can be a vital part of a responsible capital strategy." Yet alongside underinvestment in innovation, human resources and capital investment, large share repurchases and dividends send a "discouraging message" about the ability of corporations to create long-term value, he thinks.

According to Pat McHugh, a Senior Managing Director at Okapi Partners, the letter is likely to be influential. "Given BlackRock's size and the fact they invest in pretty much every company, clearly you have to consider what they have to say," he told Activist Insight. Nonetheless, he thinks there is a risk it could be misconstrued.

"Fink makes some valid points," McHugh explains. "My fear is that some management teams would take it to mean BlackRock would support them unconditionally. That's not how I read this."

> "Without the potential for activism, many boards would act in a different way"

Not against activists per se

In the letter, Fink himself is at pains to stress that his stance does not mean turning his back on activists, whom BlackRock backed in more than half a dozen proxy contests last year. "Nor are the demands of activists necessarily at odds with the interests of other shareholders," he writes. "[S]ome activist investors take a long-term view and have pushed companies and their boards to make productive changes."

In fact, Fink is merely arguing that if companies want the benefit of the doubt when confronted with an activist, BlackRock's support "will rest on [the companies'] ability to both develop and communicate their plans for future growth." Many institutional investors have been keen to support activist investors because of their impact on corporate governance, and this is an area in which issuers will have to continue to be on their best behavior, according to McHugh. "Without the potential for activism, many boards would act in a different way," he says. "Overall, boards are behaving better because they don't want to become an activist target."

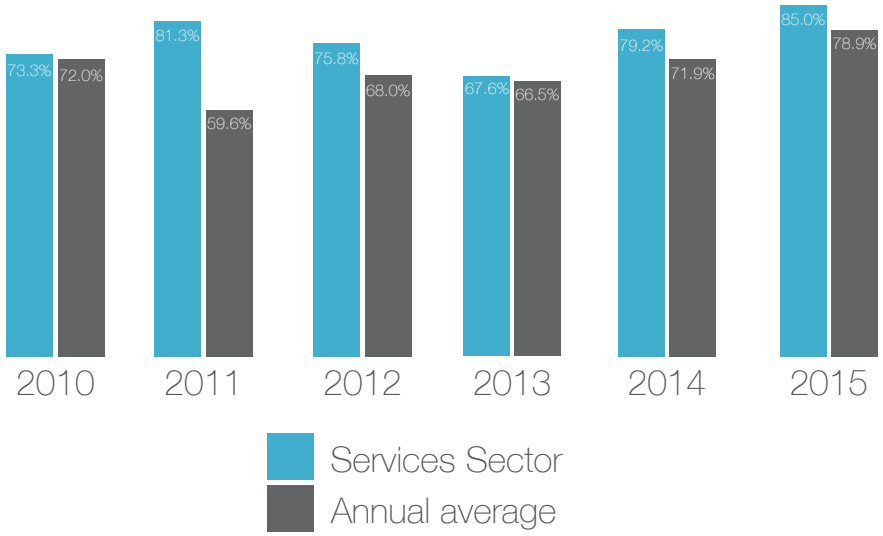
A defining shift?

With the Federal Reserve potentially eyeing an interest rate rise this year, the era of dividends and buybacks may be over in any case. McHugh thinks much of the activist agitation for these goals is dictated by the current openness of the capital markets, rather than it being hardwired into their approach. A slight uptick in M&A at the beginning of 2014, with the US market currently running at the highest level since 2007, according to Dealogic, suggests new priorities.

But Fink's contribution to the time-horizon debate may be remembered more for a legislative proposal, if supporters in Washington are emboldened enough by the improving economic climate to take on the activists. For tax purposes, Fink points out, the US currently defines a long-term investment as one held for one year. And, he suggests, "Since when was one year considered a long-term investment?" ■

Activism in numbers

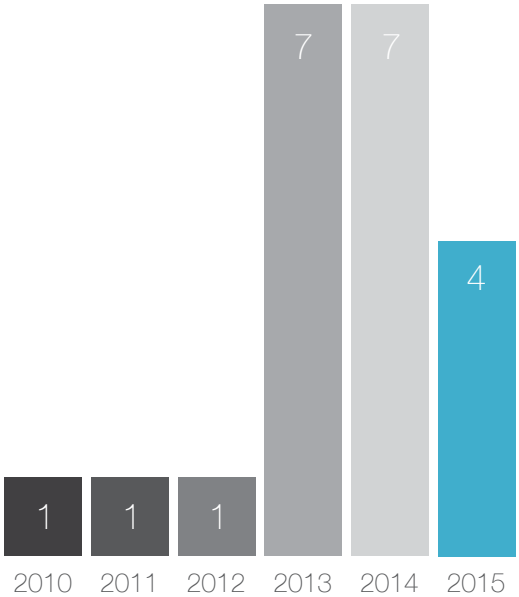
They live to serve



Not only is the services sector popular among activist investors these days, but it may be easy pickings. The outcome of public demands has proved more favorable to activists in this sector than an average of all demands in each year since 2010. Ongoing campaigns were excluded from the data.

Activism's big in Japan

It's not just Dan Loeb who loves Japan right now. The number of campaigns at Japanese companies has risen sharply in recent years and looks set to be higher still after a storming start to the year.



35.8%

Percentage of current* S&P 500 companies which have had an activist on their shareholder register since 2010

16.6%

Percentage of current* S&P 500 companies subjected to public activist demands since 2010

*As of April 2015

Dominating the index

With the enticing prospect of big returns, activists have found themselves drawn to the biggest club of US stocks, the S&P 500. More than one-third of the Index as currently populated has had an activist on its share register in the last five years, and just below one-in-five have faced public demands from an activist.