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VINSON & ELKINS LLP

ACTIVISM CONFERENCE REPORT

ENERGY ACTIVISM IN NUMBERS

ACTIVISM MONTHLY *Lite*

Activist Insight

In association with

Vinson&Elkins LLP

Editor's letter

Josh Black, Activist Insight

This month's edition of Activism Monthly Premium magazine has a special focus on activism in companies in the energy markets, which is timely given current concerns about the oil market. In a month where crude oil dipped below $85, albeit briefly, there have been concerns about the sustainability of many companies' business plans.

As our feature article shows, this brings both pitfalls and opportunities for activist investors. On the one hand, some investors who have waded deeply into the energy market are now looking to get themselves out of tricky positions. Lower prices eating into quarterly earnings could mean many cut their losses and run. Attiva Capital, an occasional activist with a penchant for emerging markets, tweeted last month that oil was "headed towards $50." An almost apocalyptic prediction, to be sure, but even a more gradual slide would cause some companies trouble.

More attuned investors may hope to spot bargains, however, particular in infrastructure-heavy companies that can be restructured in a more shareholder-friendly format, such as a REIT or MLP, or sold to a bigger player. Regular readers may remember last month's discussion of Bellatrix Exploration, a Canadian company subject to some interest recently from Daniel Lewis' Orange Capital. A private equity swoop for some of Bellatrix's assets is exactly what Orange Capital would like to see, while Civeo is also likely to see some activism over its decision not to become a REIT but to instead re-domicile to Canada to enjoy lower corporate taxes.

> "Some investors in energy markets are looking to get themselves out of tricky positions"

We are fortunate to have input this month not only from some experienced investors, but from some of the pre-eminent advisers in the energy space. Vinson & Elkins, a Houston firm originally but increasingly a global one, is frequently named the world's leading energy law firm, and have kindly sponsored this month's issue of Activism Monthly. For them to say that activism is the number one external issue in the boardrooms of companies they advise says a great deal about the vulnerability the sector feels it has acquired over the past three years.

Indeed, the impact of activism on Calgary was one of many topics being discussed on the fringes of the Arrowcon Partners Activist Investing in Canada conference in mid-October. With not only this conference, but also several others on activism or securities regulation taking place at the same time, Canadians continue to have an intense interest in activism. Since at least seven activist firms and more or less all of the major players on the advisory side were represented at the Activist Investing conference, this had a good claim to being the most comprehensive conference of all, and we have tried to bring you the best insights from the day later in this issue.

Of course, this was also the month that Carl Icahn said Apple was trading at "half price" and Bill Ackman listed his Pershing Square Holdings fund on the Amsterdam Stock Exchange. Activism Monthly Premium is often described as the only publication dedicated solely to the activism space, and yet we feel it is worth reminding readers of our Lite, online version that a whole lot more awaits them in the paid-subscription print version. Coming to the end of our first year of publishing, we are keen to hear feedback from our readers and will increasingly be soliciting opinions with a view to staying ahead of the game in 2015.

For now though, thank you for reading, and feel free to get in touch with any questions.

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Activist Insight

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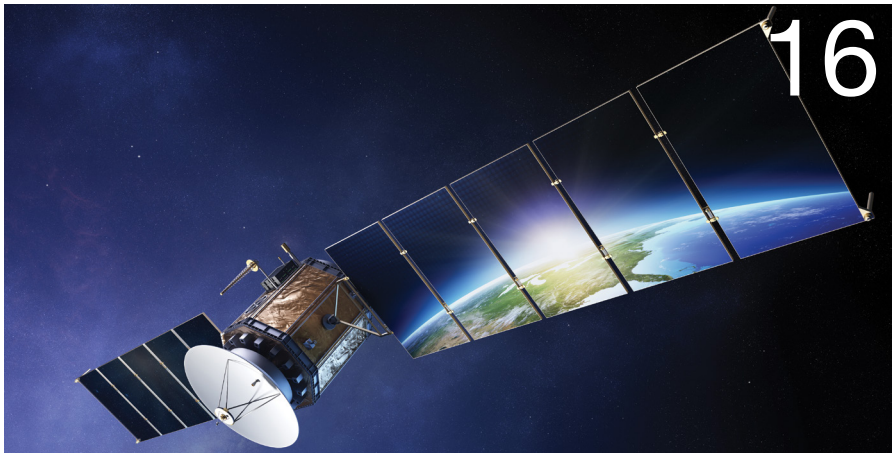

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Activism Monthly Premium

Market leading analysis, interviews with key players and the critical developments in activist investing

Activist Insight

Activism Monthly Premium magazine is the authoritative source of thought leadership and editorial in the activist investing space.

> Great articles on shareholder activism"
>
> *Carl Icahn*

Feature articles, expert opinion, interviews with key players, campaign analyses, news round-ups and much more!

> "I've been impressed by the thoroughness and accuracy of Activist Insight's research. I believe Activism Monthly Premium is 'must read' information both for activists and the advisory firms increasingly providing services around shareholder activism."
>
> *Greg Taxin, formerly of Clinton Group*

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The tip of the iceberg

Vinson&Elkins LLP

An interview with Kai Liekefett and Stephen Gill

Have you noticed an upsurge in activism in the energy industry recently?

Kai Liekefett: Up until 2012, activists weren't really focused on this sector. But in the last three years, there were more than 30 reported activism campaigns in the U.S. and numerous activist situations that were resolved outside the public eye.

What's behind this rising activity in the sector?

Stephen Gill: There have been three drivers that we've seen. First, the shale boom has changed the industry. The U.S. is now a leading producer of oil and gas in the world. The problem is that energy companies incurred record capital expenditures in the midst of the shale boom, while at the same time oil and gas prices have fallen and near-term profitability has been reduced.

Second, in this industry, a lot of companies are susceptible to financial engineering. Many energy companies have upstream and midstream assets; some also have downstream assets. The market currently rewards pure play companies, which drives activist demands for spin-offs and other divestitures, in particular drop-downs into master limited partnerships, or MLPs.

And third, the energy industry has, for better or for worse, an entrepreneurial or wildcatter culture, which has led to activists calling for better corporate governance at energy companies. Now, I think that focus is a bit overblown, but institutional investors and proxy advisory firms care about governance, and activists are playing to that audience.

> "In this industry, a lot of companies are susceptible to financial engineering"

Are companies of all sizes being affected?

KL: It's really happening all over the energy industry. Size is no longer a deterrent to activism. Last year, Elliot waged a proxy fight against Hess, which was then a $25 billion company. This year Apache, a $30 billion company, has become the target of Jana Partners. The bread and butter of activism in the energy space, however, are small- and mid-cap companies. Some activists such as Loan Star Value specialize in targeting those companies. Indeed, smaller oil and gas companies sometimes have more room for improvement than mid- or large-cap companies.

Do activists need expertise in this industry to be successful?

SG: The industry has unique characteristics that need to be understood, but that doesn't preclude the same plans being replicated. Understanding how oil and gas companies and their assets are valued, and how they perform is important. Also, the accounting requirements for oil and gas reserves can be a trap for the unwary. That said, we've seen most of the well-known activists investing in the sector, and we expect those that haven't, like Pershing Square or Trian, to target the energy industry before long.

What are some of the arguments that do or don't resonate in the industry?

KL: Let's start with what most often doesn't work: The long-term vs. short-term debate. Institutional shareholders care primarily about the situation at hand, and therefore we advise clients to focus on near-term or mid-term results in a campaign. This may be regrettable because whether activism is beneficial or detrimental to our

"ACTIVISM FACILITATES DEALS, BUT IT CAN ALSO HAVE A CHILLING EFFECT"

Kai Liekefett

Steve Gill

> "This is now the number one topic in our clients' boardrooms"

economy in the long term remains an important question.

SG: What does resonate is a coherent strategy, which is easily understood by analysts, the market and investors generally. Proactive engagement with your shareholders is critical – you need to be able to explain your strategy to a non-activist. Other than that, we advise our clients to sit down and have a productive private meeting with the activist. Campaigns won't see the light of day if you can convince an activist that their plan won't work.

Has this increased activist activity had an impact in the boardroom?

SG: Beyond the usual industry trends, this is now the number one topic in the boardrooms of our clients. As a result, boards are more sensitive to it. It can get personal, but on the whole directors are willing to listen to activists' ideas. There's a lot more openness in terms of change, these directors are not zealots to their own ideas. Also, activists have become more sophisticated and the quality of their nominees has become a lot better. Some boards might have financial expertise, but an activist may come along and say, "I've got one of the best COOs in the industry among my nominees."

Does Vinson & Elkins represent activists as well as issuers?

SG: As a leading law firm in the energy sector, we represent only issuers in this space. We have held discussions with some of the well-known activists about other sectors and have represented "occasional activists" in other industries, however. For example last year we represented an investment fund in its proxy fight to stop the $6 billion merger of Clearwire and Sprint. After four adjournments and an intense campaign, the merger consideration was eventually increased by around 70%.

What do you expect to see from activists in this sector in the near future?

KL: We think we've only seen the tip of the iceberg. Many activists have discovered this sector and we think that more will invest in the coming years, especially as valuations in equity markets may not reflect the intrinsic value of energy companies. There's also a relationship between activism and M&A activity in the sector. Activism facilitates deals, but it can also have a chilling effect, as there have been concerns about how transformational deals might be attacked by activists. Therefore, our clients have become careful about deals that are not immediately accretive or where synergies are not immediately apparent to the market.

Vinson & Elkins LLP is an international law firm with approximately 700 lawyers across 15 offices worldwide. More than 400 V&E attorneys regularly advise clients on energy-related matters. Kai and Stephen are based in the firm's offices in Houston, Texas.

Activist Investing in Canada: Conference report

Increased interest in activist investing in Canada ever since Pershing Square Capital Management's stunning victory over Canadian Pacific has left many seeking to understand what activists are looking for and how they build support, and this event provided an unbeatable introduction. With Pershing Square, Kerrisdale Capital, Engaged Capital, FrontFour Capital Management and VN Capital all represented on panels or in "fireside chats," that introduction came direct, as well as from the advisory side.

For one, Kerrisdale's Navi Hehar sees activist investing in a romantic light. "Some guys like to message a girl up privately on Tinder, others send a dozen roses to her workplace," he told the audience at the Arrowcon Partners Activist Investing in Canada conference. "We do the latter, and we call all her workmates and tell them to share their views."

Indeed, grand gestures are a permanent fixture of the activist landscape on both sides of the US-Canadian border. Engaged Capital's Glenn Welling, who prefers to stay out of the limelight where possible, admitted to the crowd that the media had its uses. He went public with the threat of a proxy contest at Abercrombie & Fitch after his concerns were dismissed, and within weeks the company had added seven new directors. More often, he faces up to a CEO or Chairman privately, over dinner. Sometimes the companies continue to stall. Yet as Wes Hall, of Kingsdale Shareholder Services, quipped, "When you have dinner with someone, you have to expect that something's going to happen."

Nervousness about activism is therefore understandable. Gregg Feinstein, of investment bank Houlihan Lokey, says activism is on its way to being viewed as a threat at the same level as hostile takeovers in the 1980s, with similar efforts at preparedness taking place. Activism now affects companies not merely at board level, but in all walks of business, including on deals, with Feinstein saying roughly a third of M&A activity is stimulated by activists. According to Scott Winters, a Managing Director at proxy solicitor Innisfree, "The days of signing a merger agreement and that being

"THE DAYS OF SIGNING A MERGER AGREEMENT AND THAT BEING THE END OF IT BECAUSE SHAREHOLDERS WILL BACK YOU REGARDLESS ARE OVER"

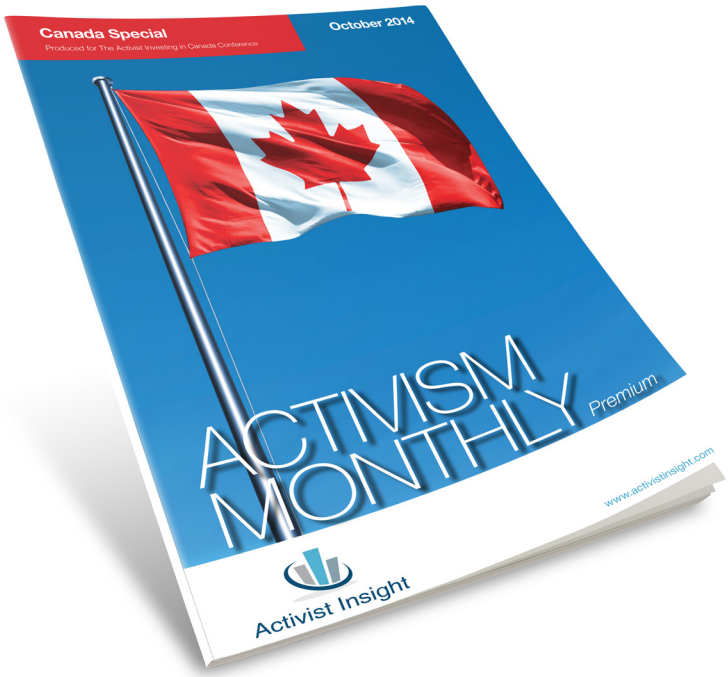
> "Everyone thinks they can go a round with Mike Tyson until they get the first punch"

the end of it because shareholders will back you regardless are over."

Hall says he has a call once a week from an activist, but only acts on instances where the dissident is prepared to put up serious cash and has an attractive value proposition. When acting for companies, he first speaks to major shareholders to determine how much support management can rely on. Where that support is limited, he recommends negotiation. "Everyone thinks they can go a round with Mike Tyson until they get the first punch," he says.

Norton Rose Fulbright's Orestes Pasparakis, a Co-Head of the Special Situations team at the law firm, cautions his clients to beware of "sheep in wolves' clothing," saying that although there are lots of opportunities in Canada, there are few real activists. Yet in the same week as the Ontario Securities Commission announced it would hold the reporting threshold for investments at 10% of a company's equity and not require greater disclosures of derivatives, the friendliness of Canada's regulatory framework to activism remains unquestionable.

Nonetheless, differences remain. The early warning report, used when an activist acquires more than 10% of a business, requires an immediate moratorium on trading and an announcement within a couple of days at most, unlike Schedule 13D, which grants a ten day window before disclosure. Poison pills, previously used mostly for a 60-day halt in hostile bids, can now stretch to 120 days and there is talk of a threshold below 10%. Many companies have adopted advanced notice bylaws to prevent nominations from the floor—those that don't have to maintain a heightened level of preparedness.



Activist Insight was a media sponsor of the inaugural ArrowCon Partners "Activist Investing in Canada" conference and produced a special edition of Activism Monthly Premium magazine for attendees.

The document features interviews with conference speakers Walied Soliman and Orestes Pasparakis, of Norton Rose Fulbright, Wes Hall of Kingsdale Shareholder Services, and Paul Hilal of Pershing Square Capital Management. Those interested in receiving a copy can request a PDF by e-mailing press@activistinsight.com.

Activism in numbers

High energy activists

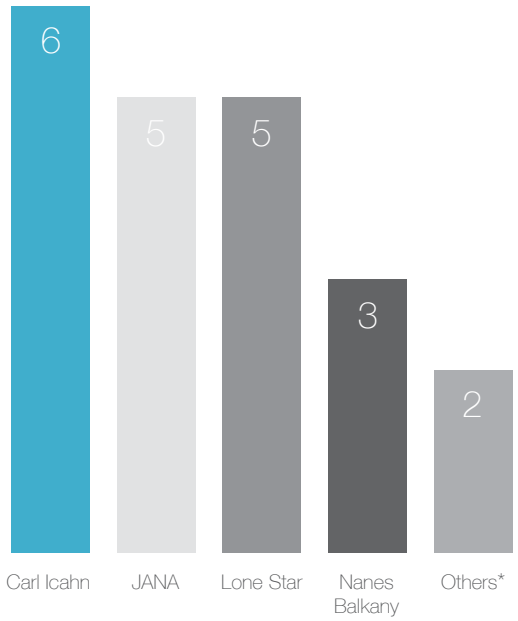


Fig 1: Number of campaigns launched by activists in the energy sector since 2010

Several activists have made the energy sector something of a specialty since 2010, despite being regarded as generalists. Carl Icahn has led campaigns at six different companies, according to Activist Insight, while JANA Partners and relatively new firm Lone Star Value Management are on five each. These include billion dollar companies, like Apache, Marathon Petroleum and Oil States International, as well as micro-caps like Antares Energy and Callon Petroleum.

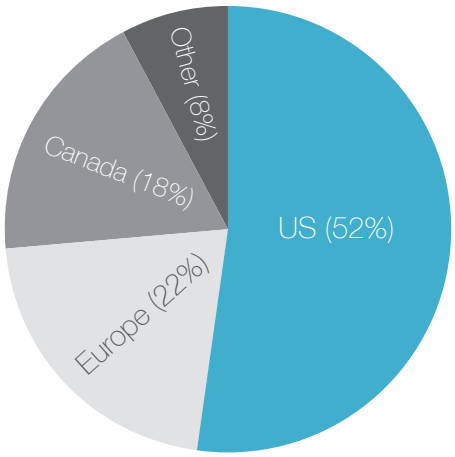
In all, just under 50 investors have led activist campaigns in the sector since 2010.

* Atlantic Investment Management, CalPERS, Osmium Partners, Sandell Asset Management, West Face Capital, Worldview Capital Management

US biggest stage for energy activism

Fig 2: Location of activist targets in energy sector since 2010

The challenge faced by American energy firms is highlighted by the fact that more than half of the activist targets in this sector are based in the US. Carl Icahn's recent forays into Swiss firm Transocean and Canada's Talisman Energy highlight the global reach of activism in this sector.



Energy sector subject to array of strategies

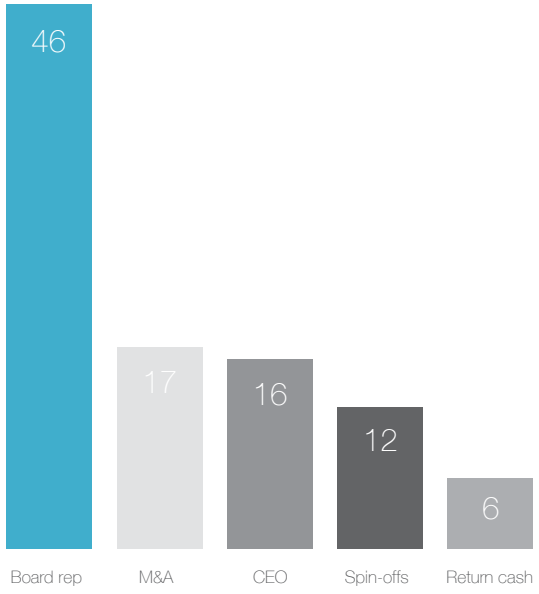


Fig 3: Frequency of activist tactics used in the energy sector since 2010

As in most sectors, activists investing in energy companies are keen to join the board in order to influence everything from operations to spin-offs and strategic planning. Board representation is therefore the dominant public demand made by activists, with twice as many campaigns as the next most frequent.

That said, the sector has its own trends, and consolidation and divestment strategies are popular with activists, as evidenced by the number of campaigns focused on M&A or spin-offs. Finally, the removal of powerful CEOs or founders, often deeply embedded in the fabric of energy companies, remains a popular tactic.

Activist Insight Online

The definitive resource on activist investing

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