Activist Insight

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Activism Monthly

...your monthly digest of activist investment

Banking on activism

Shareholder activism in the US banking industry has rarely been considered a blockbuster in terms of the public imagination. Indeed, a recent paper on the subject by the law firm Skadden, Arps, Slate, Meagher & Flom LLP concluded that shareholder activism "has not been at the top of the agenda of many banking institutions" over the past five years. In that period, among the largest bank holding companies only Boston's State Street Corporation has come under sustained assault, while the likes of JP Morgan Chase have been targeted for changes to their governance.

Nonetheless, activism in the financial sector has been consistent over the last few years (see fig. 1 – financial sector inclusive of banking), and in particular at the community banking level. Several activists have even made the sector their hunting ground, with the likes of Lawrence Seidman, Stilwell Value LLC and PL Capital LLC each notching up a number of proxy contests each year.

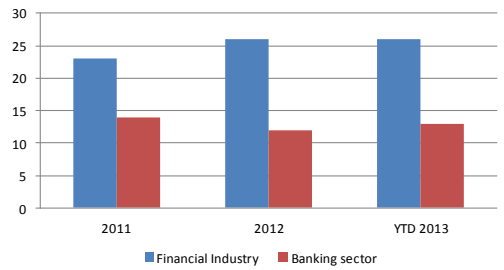

Figure 1. Activism in the financial sector globally, with banking investments represented as proportion of the total. (Source: Activist Insight)

Sven Mickisch, a Partner in the Financial Institutions Group at Skadden and one of the authors of its report on shareholder activism in the US banking industry, says that activism in general has been picking up in the last couple of years. Those specializing in banking are wondering, according to Mickisch, "is it just a matter of time until the trend extends into banking and, if so, how should those in the industry prepare?"

Rich Lashley and John Palmer from PL Capital have been using activism at banks for 17 years now. They see the current climate as perfect for activism, noting that the window for M&A activity is "wide open". With banks under pressure to raise their capital levels and costs rising, the only way to increase profit margins is through consolidation. When two banks undertake a merger, the buyer can often cut out upwards of 45% of the seller's costs, according to the PL Capital playbook. The cost savings allow even marginally profitable banks to obtain premium bids for their franchises.

Banks "are more amenable to doing deals [in the current climate]," says Lashley, "but a lot don't. That's why we're activists." He gives the example of a Baltimore bank (BCSB Bancorp) where he got a seat on the board and supported the company's efforts to find a buyer. In the end, BCSB sold for 60 times the bank's earnings. "Was that rational?" asks Lashley. "Yes, it was rational, because cost savings meant the price paid was really 12 times earnings. It was a home run for everyone on the sell-side, and the buyer was happy too."

The Skadden paper notes that a change in market conditions could unleash a wave of banking activism and are warning their clients to prepare accordingly. The law firm's briefing paper notes that "the absence of a robust bank M&A market" at the level of the larger banks has limited the

Activism goes global... India

Anecdotal evidence suggests that shareholder activism by foreign and domestic investors may be on the rise in India, a year after The Children's Investment Fund ran a high profile campaign to end subsidized energy prices at Coal India. Since then, TCI has had to fight against large government interests in the company and India's slow and onerous legal system – two factors which have historically hindered activism in India.

Umakanth Varottil, a Law Professor at the National University of Singapore who has written a paper on shareholder activism in India, says that activism takes a unique form in India. "So far, there has not been the kind of activism you would see in UK and US markets. Instead, we have mostly seen shareholders showing up to vote in larger numbers against management proposals. Protest votes are far more common than direct engagement."

However, Professor Varottil also thinks that this could change. Earlier this year, the securities regulator announced that insiders would be barred from voting on a number of different corporate events, including transactions with related parties and amalgamations.

In addition, a new Companies Law was implemented that will allow shareholders to bring class actions with the support of a minimum of 100 shareholders or 10% of the company's share capital. "When the stakes are high, this shouldn't be too difficult", says Professor Varottil.

Global Activism Spectrum:

Feature: Continued

potential for activists to exit their investments once their work is done, or if things go wrong. At the smaller end of the asset scale, activists say that they can always sell their stock back to the bank.

The strategy makes sense for a skilled activist. PL Capital's Financial Edge Fund has returned an annualized 11.8% since its inception in 1996, almost double the growth of the S&P 500 Index and more than three times the growth in the SNL Thrift Index.

Another way the fund prospers in the banking industry is by getting in early. America still boasts a decent number of old mutuals in the process of converting to joint stock banks. When stock is distributed to depositors, it is usually quickly turned over into the hands of institutional shareholders and its price can increase rapidly. Johnny Guerry, Managing Partner at Clover Partners LP – a banking specialist and an activist 'of last resort' – says a typical by-product of a conversion is that the bank has "copious amounts of capital". This leaves the bank manager thinking about whether their balance sheet is rational, or whether he should pair up with a similarly sized partner.

According to Activist Insight data, Joseph Stilwell's Stilwell Value LLC remains the busiest activist in the banking sector. Yet PL Capital isn't far behind, and has a number of campaigns ongoing. It is shortly due to fight a proxy contest at Alliance Bancorp Inc, a Pennsylvania community bank. Clover Partners and Stilwell were also in the stock recently according to their latest regulatory filings – a sign of how niche the space is currently – but ownership thresholds prevent these activists from collaborating very frequently.

This is not to say that there aren't tougher restrictions for activists in the banking arena than other sectors. As the authors of Skadden's briefing paper point out, activists come under greater scrutiny from regulators. David Ingles, a Partner in the Financial Institutions Group at the firm, says regulators are "very cautious about capital levels and financial health" at banks, potentially limiting traditional forms of activism such as calling for dividends and share repurchases. Moreover, 'control' of financial institutions is defined more strictly. "Historically, you've been able to own 9.9% of a bank without filing a change of bank control notice," says Ingles. In recent years, however, Federal regulators have started to take a tougher stance, in one instance even limiting a dissident slate to one nominee.

Nonetheless, Lashley and Palmer at PL Capital are optimistic, saying an M&A wave has begun and will last another two-to-three years or longer. They currently have around $200 million assets under management, but when Activist Insight asked whether a larger bank could come under attack they are unequivocal. "Believe me, we've thought about it," says Lashley, who says his fund will partner up to move to the next level, if and when the Fed sends a clear signal that it will allow larger banks more freedom to consolidate.

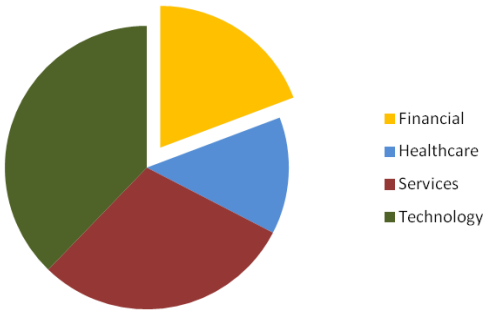

Figure 2. Global activist campaigns by sector, 2013 (source: Activist Insight)

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- ***News*** – Get the latest news on activism including key developments in all the latest activist situations.
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- ***Company Profiles*** — See detailed profiles of over 2000 issuers that have been targeted by activist investors worldwide.
- ***Activist Campaigns*** — Identify activist campaigns by activist strategy, company response and campaign outcomes.
- ***Performance*** — View the annual and compounded net returns of Activist Insight's performance index for activist funds.
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News in brief: our monthly round-up

New Investments in November:

Activist	Company	Stake
Eminence Capital	Men's Wearhouse	9.80%
Elliott Management	Riverbed Technologies	9.00%
ValueAct Capital Partners	Allison Transmission Holdings	9.90%
Carl Icahn	Hologic Inc	12.63%
Smoothwater Capital	Equity Financial Trust	12.35%

In the News:

Bill Ackman invested $401 million in mortgage securitization companies **Freddie Mac** and **Fannie Mae**, following chatter that Fairholme Capital Management had proposed to buy parts of the companies. However, the Obama administration rejected the plans, leaving the purpose of Pershing Square's investment unclear.

Elliott Management increased its stake in German drugs distributor **Celesio AG** to over 25% as it seeks to block a takeover by McKesson.

ADT repurchased shares owned by **Corvex Management LP**.

Hewlett-Packard adopted by-laws to ease shareholder nominations to its board, but only for those who held a 3% stake for more than three years.

Provident Financial's AGM approved a by-law designed to prevent activists from compensating nominees.

Men's Wearhouse offered to acquire **Jos. A. Bank Clothiers**, after the latter's offer to acquire it lapsed. **Eminence Capital** turned activist when a merger appeared to collapse earlier in the month.

Sadar Biglari failed in his third attempt to gain board representation at Cracker Barrel Old Country Store.

Campaign to watch...

Bulldog Investors

Firsthand Technology Value Fund & Javelin Mortgage Investment Corp

Bulldog Investors LLC didn't run a proxy contest in the first half of 2013, but all of a sudden two have come along at once. The activist, still one of the busiest around but less aggressive in recent years, announced last month that it would nominate directors at two companies. Then again, it has history with management in both cases.

Firsthand is a closed-end fund with big stakes in Facebook and Twitter. Back in September, the stock was doing well and Bulldog began to sell shares, with Phil Goldstein admitting that, despite his past antipathy to fund manager Kevin Landis, the stock was on a good run. Twitter's IPO came and went, but Goldstein told Activist Insight recently that shares in Firsthand didn't match the micro-blogging stock, instead falling 7%. "The discount widened to 20%," he says. "No one can understand that, so we turned around and started buying shares again."

Bulldog is seeking to add two directors to the board and encourage Landis to repurchase shares. However, the proxy contest could be a turbulent one. Earlier in the year, Landis sued Goldstein over an episode where Bulldog forced the resignation of independent director, Rodney Yee, and the ill feeling is likely to continue.

At Javelin, a US Real Estate Investment Trust, Bulldog has nominated six candidates and wants shareholders to vote on a proposal to enhance the REIT's buyback policy. Behind the scenes, Bulldog has pursued a slightly more conciliatory line. It has had talks with management, and says the $2 million stock repurchase authorization is sufficient, so long as the company pursues its programme aggressively. Says Goldstein, "They have the authorisation, they should be able to buy those shares within six months. If they don't, to me that affects their credibility."

Despite Bulldog's willingness to settle - and over the last few years it has settled more frequently than it has gone the distance in a proxy fight (something Goldstein puts down to his firm's enhanced credibility and negotiating prowess) - Goldstein says the only thing Bulldog can sacrifice is to drop its proxy contest. If Javelin doesn't offer something in return, Bulldog is likely to be gearing up for a busier proxy season in 2014.

13D Digest November

Activist 13D's	14	↓
Activist 13D/A's	76	↑
New Activist Funding	$1,412,473,157	↑

Activist Insight...

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