

2017

ACTIVIST INVESTING

An annual review of trends in shareholder activism



Activist Insight

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Editor's letter



Josh Black, Editor-in-Chief at Activist Insight.

Of the four years I have reviewed for Activist Insight, 2016 seems the longest and most contradictory. If the years leading up to it were marked by the growing ambition of activists, leading to a rise in bigger demands, bigger targets and bigger paydays, 2016 saw something of a stepdown. As this report highlights, economic and governance activism is an increasingly diverse field, with the activity of specialist activist funds slowing by some measures.

And yet, in our mid-year survey of activists, *Shareholder Activism Insight*, 56% of respondents said they expected the volume of activism to remain the same. A sizable minority – 32% – expected an increase. That seems hard to believe, given how busy 2016 felt, but it is certainly plausible that 2017 will provide plenty of new opportunities.

Of course, dedicated activist investors were hardly insignificant in 2016. Indeed, they continued to break new ground, picking up board seats that would have been unthinkable years earlier. They finally pushed Yahoo to sell its core business and continued to be involved in mergers and restructurings the world over. Activist Insight data suggest that the more central activism is to an investor's strategy, the more likely it is that its demands will be met.

Nonetheless, 2016 may be remembered more for what activists sold than for what they bought. Big stakes in Apple, Canadian Pacific Railway, Darden Restaurants, PepsiCo, Qualcomm, and Walgreens

were liquidated. Their replacements in activist portfolios often underwhelmed, whether because of the tameness of the investment theses, the duration of the investment, or the size of the targets. Atypically, Carl Icahn took an approximately \$820,000 position in drug company Allergan, asked for nothing, and sold almost all his shares quickly.

“Even with Icahn as his special adviser, what Trump's election heralds for activism remains to be seen.”

Another theme worth highlighting is that, for activists, 2016 was an inherently political year. Deals between Staples and Office Depot, and Baker Hughes and Halliburton foundered on antitrust concerns, while in the latter case, the U.S. government sued ValueAct Capital Partners for alleged non-compliance with disclosure rules. Several legislative attempts to regulate activists were floated before the election of Donald Trump as president in November. Even with Icahn as his special adviser, what Trump's election heralds for activism remains to be seen.

Elsewhere, however, governments seem keen to promote the role of shareholders in corporate governance. In the U.K., the government seemed eager to offer investors new powers, while South Korea may follow Japan in adopting a corporate governance

code after a scandal illuminated by an activist campaign.

A world which sometimes runs parallel but occasionally collides with shareholder activism is activist short selling – an expanding part of our coverage here at Activist Insight following our acquisition of *Activist Shorts Research*. Activist short sellers had a big year surfing volatility in 2016, and even ventured into new markets in Asia and Europe. They, too, seem likely to proliferate, especially given the lack of disclosure in many markets and their ability to publish anonymously online.

This report showcases many of the different strengths of our platform. 2017 opens with Activist Insight offices in three time zones, offering four great products and renewed ambition to provide the most comprehensive coverage of activism worldwide. There is a growing team behind this report and our flagship magazine, *Activist Insight Monthly*, to whom I am indebted for their hard work.

I also want to thank our sponsors, especially Schulte Roth & Zabel. We are grateful for all the support we've received over the years, leading up to this exciting moment, and look forward to working ever-more closely with our clients. The 12 months ahead of us may be filled with twists and turns, but it will be quite the journey.

P.S. Drop me an email to subscribe to my weekly newsletter on activism.

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Onward and upwards



Marc Weingarten and Eleazer Klein, co-chairs of Schulte Roth & Zabel's global Shareholder Activism Group.

A change in the mix

While activist campaigns may not have commanded as many newspaper front pages in 2016 as they have in recent years, this reflected more of a down-market shift in activist targets and not any retreat by shareholders. Many activists focused on smaller targets during the year, while some of the largest and most-feared activists had a quieter year retrenching in the aftermath of lesser performances in 2015. Nonetheless, the number of activist investments across the globe actually slightly increased versus the previous year, although there was a slight decline in North American volume.

“More and more investors who would never call themselves activists have entered the activism arena.”

There were a myriad of contributors to this pause in the growth of shareholder activism. Many of the major activist funds had their first down years in 2015, led in some cases by the collapse of Valeant's stock and poorly-timed energy bets, and their losses continued into the first quarter of 2016. As a result, they were more focused on investor relations and increasing liquidity than taking on new large cap campaigns (with Elliott and Starboard Value being major

exceptions). The uncertainty resulting from the “Brexit” bombshell and the U.S. election also slowed activity. But much of that macroeconomic uncertainty has now been resolved, with Brexit going “hard” and the Trump administration firmly in place, and with more positive returns for the major activists during the balance of 2016 and their investor base stabilizing, we are expecting more action in the large cap space this year. With the newly-ensconced Paul Hilal pursuing CSX, this trend is already underway.

Rise of the occasional activist

As “reluctivists” have been emboldened by the success of activist investors, the occasional activist is becoming a more familiar sight. More and more investors who would never call themselves activists have entered the activism arena. Occasional activists are almost always long-term investors in their targets and typically have engaged with management for many months – if not years – before resorting to the activist playbook. Investment managers fed up with a portfolio company's management and lack of progress have recognized that activist engagements can be a useful tool to catalyze the changes needed to deliver returns. These funds often believe that their role as fiduciaries for their investors requires them to sometimes pursue an activist strategy, instead of simply disinvesting. Our clients Altimeter Capital, with a successful campaign at United Airlines, and St. Denis J. Villere & Company, which pushed

Epiq Systems to a sale, typified the sector. And 2016 saw several more traditional managers turn into occasional activists, like Neuberger Berman at Ultratech and T. Rowe Price at NetSuite.

Redefining proxies in the United States

In 2016, the Securities and Exchange Commission released a long-awaited proposal for universal proxies at the behest of our client, the Council of Institutional Investors.

The proposal would require the use of universal proxies in election contests, in order to enable shareholders to vote for the combination of board nominees of their choice and replicate the action they could take by attending a shareholder meeting in person. While activist defense advisers have reactively decried universal proxies as tilting the playing field to favor activists, which in fact is not the case, they would certainly change the dynamics in proxy contests. With the change in administrations, and at the SEC, it remains to be seen whether this proposal has legs.

Back on the growth track

So following a bit of a pause last year, we see the activist sector returning to its historic growth trajectory, not just in the United States but on a more global basis as well. And preparing for that growth, we welcome our new partner, Aneliya S. Crawford, to our activist team at Schulte Roth & Zabel. Onward!



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Hype and humility

Shareholder activism proliferated in 2016, but dedicated activists were responsible for fewer than half of global campaigns thanks to volatility and smaller war chests, reports Josh Black. Getting heard above the crowd may be harder in 2017.

The juggernaut of shareholder engagement kept rolling in 2016 as a surge of one-off campaigns, governance-related proposals and remuneration crackdowns made for a busy year. 758 companies worldwide received public demands – a 13% increase on 2015's total of 673 – including 104 S&P 500 issuers and eight of the FTSE 100.

Yet for dedicated activist investors, it was a more muted affair. Investors deemed by Activist Insight to have a primary or partial focus on activism targeted fewer and smaller companies, accounting for just 40% of the total which faced public demands, and 10% fewer companies in North America. Turbulent markets, redemptions and competition all played a part in reducing the volume of activist investing. By contrast, shareholder engagement flourished.



“Investors deemed by Activist Insight to have a primary or partial focus on activism targeted fewer and smaller companies, accounting for just 40% of the total which faced public demands.”

With hangovers from poorly timed investments in energy markets, the near-demise of Valeant Pharmaceuticals International and antitrust concerns breaking up deals on which activists had bet substantially, dedicated activists enjoyed a particularly poor start to the year in the U.S. Jason Ader, the CEO of SpringOwl Asset Management, told Activist Insight for this report that 2016 might be “the year that activists were humbled.”

“Co-investment, meanwhile, remains a favored strategy for both new and old activists.”

However, the number of newly engaged investors suggests the feeling is not widespread. According to Activist Insight, 51 primary, partial or occasional focus U.S. investors founded since 2009 launched their first U.S. campaign in 2016, up from 38 the year before. Although the data include recently founded activist firms, the universe of activists is expanding rapidly.

Indeed, engagement activists, typically institutions or individuals that push for governance changes, targeted 155 companies worldwide in 2016 – up 24% after three years in which activity had remained flat. But it was “occasional” activists – which do not include activism as part of their regular investment strategy but which make infrequent public criticisms of portfolio companies – that account for

the highest volume, making demands at 311 companies.

Not all of these demands trouble management equally. Only 58% of resolved demands initiated in 2016 were at least partially successful, with the rate of achievement rising with the focus level of the activist. That rate may yet fall as campaigns are resolved, with 2014 and 2015 both posting around 53% at least partially successful.

Downsizing

One of the most notable trends of the year was the strengthening of small cap activism, at the expense of the large targets activists have increasingly pursued. While the number of targeted companies valued at more than \$10 billion rose marginally overall, among primary and partial focus activists it fell from 44 in 2015 to 30 last year. Indeed, in 2016, the sub-\$2 billion market cap arena accounted for 78% of all targets, up from 72% in 2015 and 70% in 2014. After mixed results, Ader says he is unlikely to repeat his PR-heavy campaigns at Viacom or Yahoo, where SpringOwl published lengthy presentations in 2016.

That may continue to be a trend this year, unless activist fundraising picks up substantially. Assets under management of primary focus funds globally fell from \$194 billion in 2015 to \$176 billion – still higher than in 2014, but their first drop in five years.

Despite the tough climate, activists are still raising funds – SpringOwl and long/short specialist Spruce Point

launched new ones, while Hudson Executive Capital and Marcato Capital have had some success with prior launches. Co-investment, meanwhile, remains a favored strategy for both new and old activists.

Major activists were undoubtedly preoccupied – Icahn by bearishness, Trian Partners by several new positions taken a year previously, and Pershing Square Capital Management by turning around Valeant, although Ackman’s fund did participate in overhauling the board of Chipotle Mexican Grill late in the year. If all three become more prolific in 2017, large caps could yet face renewed scrutiny.

Towards financials

Activism in the technology sector was proportionately flat for the third straight year, this despite activity that ensured it remained one of the most publicized areas, including Starboard Value’s brief threat of a full board contest at Yahoo before a settlement was reached. M&A continued to provide activists with an exit strategy in the sector, including for Elliott Management targets EMC, Infoblox and Qlik and other companies such as Epiq Systems (Villere & Co) and Outerwall (Engaged Capital).

Moreover, a post-election rally notwithstanding, activists that have made their living focusing on buyouts in the sector – Elliott and Viex Capital among them – are unlikely to suffer a drought, according to Evercore’s Bill Anderson.

Financial stocks have also been facing the heat, with volume up 28%

“Among primary and partial focus activists, the sub-\$2 billion market cap arena accounted for 78% of all targets, up from 72% in 2015 and 70% in 2014.”

in the U.S. and 15% globally. Proxy contests at FBR & Co and Banc of California stand out, while a rally in such stocks after the November election of Donald Trump to the presidency of the U.S. may portend more M&A among small banks and property and casualty insurers, Anderson added in an interview for this report.

The next frontier

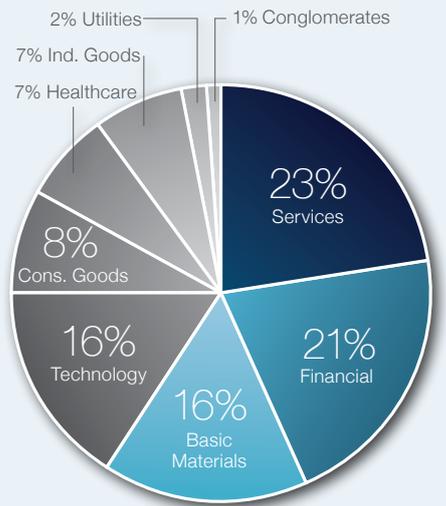
Bullish M&A markets have allowed activists to play “bumpitriage” by seeking higher offers from previously announced deals. After Britain voted to leave the European Union, a host of such mergers were exposed to calls for re-evaluations by disgruntled shareholders, as at SABMiller and Poundland in the U.K. In Europe, Elliott Management took up holdout stakes in XPO Europe and Ansaldo, while Paris-based Charity Investment Asset Management has also specialized in defending minority investors in controlled companies.

Getting a hearing became easier in Europe in 2016, with Rolls-Royce Holdings becoming the first FTSE 100 company to cede a board seat to an activist (ValueAct Capital Partners) and Active Ownership Capital winning a seat at Stada in a rare German proxy contest. Whether similar trends emerge in regions where the culture of shareholder activism remains underdeveloped, such as Asia and Australasia, remains to be seen. Back in the U.S., if securing a hearing becomes more of a challenge again, it will be due to the spread of activism, not the lack of it. 📌

Companies publicly subjected to activist demands worldwide since 2013



Sector breakdown of global activist targets in 2016



Global active activists by focus level in 2016



Market cap breakdown of global activist targets since 2013



N.B. 1. All percentages are given to the nearest whole number, and may cause rounding errors

Activism gravitates to the middle market

Smaller companies are unprepared for greater levels of activism than larger firms, says Duncan Herrington, Head of the Activism Response and Contested Situations Practice at Raymond James.

Activism in the middle market continued to grow in 2016, as top-tier activists looked further downstream and newly launched, smaller funds sought out viable targets. In recent years, both micro cap and larger companies have generally declined as a proportion of activist targets, while firms with a market capitalization of between \$50 million and \$1 billion have constituted the majority of U.S. activism targets for the second year in a row, and 2017 is expected to be on pace with that trend. Several factors could be at play in this development, such as the lower cost of building a significant position and the ease of employing M&A strategies (including more viable buyers), not to mention a broader array of potential targets across all sectors within this market cap range.

“These conflicts can become public sooner and more often escalate into a proxy fight.”

Activists targeting these mid-sized companies tend to be smaller, younger funds that can be more aggressive with their approach and demands, possibly because the activist has less campaign experience and thus a less nuanced approach, or wants a public “win” early on to establish a track record and gain credibility. Therefore, these conflicts can become public sooner and more often escalate into

a proxy fight. As a result, nearly all situations that developed into board contests in the U.S. last year involved companies with a market cap of around \$1 billion or below, with the majority involving activists with little or no known previous proxy fight or activism experience.

While more prone to an activist approach, smaller targets are generally less informed about the potential of shareholder activism than their large cap peers and, thus, less prepared. Consequently, when campaigns do mature into a proxy fight at these companies, the track record is essentially a coin flip, with activists winning some or all of the seats sought about half the time in recent U.S. proxy contests. Also, these firms may lack the extensive IR/PR and other internal resources needed to fight out several months of a public campaign – resources that a larger firm may have at its disposal. Therefore, the attention required of management and the board, distraction from day-to-day business, and associated expenses can often be disproportionately larger.

As capital committed to activist strategies remains close to an all-time high, and acceptance and support for activist proposals from other investors continues, activism as an asset class will continue to be robust, as will the number of campaigns. In the current environment, where even companies that perform well and may seem less vulnerable can be

targeted, it is critical for management teams and boards at all public companies, but especially in the middle market, to proactively think about and prepare for the prospect of an activist campaign. This includes understanding and engaging with other shareholder constituencies early on; looking objectively at and addressing perceived operational, capital structure and governance issues; keeping management and the board informed about the activism landscape and material developments; and finally having a “go-to” advisory team on standby. Given the speed and complexity at which activists operate today, the best practice is to develop a response plan and team well before a campaign is launched.



Duncan Herrington

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THE ACTIVIST TOP TEN

Each year Activist Insight creates a ranking of the most influential activists over the past year, based on the number, size and performance of their activist investments, showcasing the information available on the *Activist Insight Online* database. The following categories have been used to create a points-based ranking for this year's list: number of companies subjected to public demands, average market capitalization of targeted companies, average 2016 annualized Follower Return of companies subjected to public demands, and news stories written about the activist on *Activist Insight Online* in 2016. To qualify, an investor must be a primary or partial focus activist under *Activist Insight Online*'s classification and have publicly targeted three or more companies in the past year.

Elliott Management

Companies subjected to activist demands	14
Average target market cap	\$26.6b
Average annualized Follower Return	26.3%
<i>Activist Insight Online</i> news stories	227

For the second year in a row, Elliott Management leads Activist Insight's coveted ranking of influential activists. Spurred by its unflagging focus on the U.S. technology sector and campaigns run from offices around the world, Elliott also becomes the first activist to top the table twice.

In many ways, the accolade is not surprising. When many competitors had quiet years, Elliott continued to find an almost unparalleled number of opportunities. It made public demands at 14 companies in 2016 – a slight slowdown on 2015's 18, but higher than any other activist. Ripples from its opposition to the 2015 merger of Samsung C&T and Cheil Industries led to a corruption scandal involving the National Pension Service's voting that brought down the South Korean president, encouraged the formulation

of a corporate governance code and made Samsung Electronics, its next campaign in the country, a far more obliging target. Many an elected official must dream of such impact.

Behind Elliott's growing influence is an ongoing effort to refine the fund's process of identifying and unlocking hidden value, Senior Portfolio Manager Jesse Cohn told Activist Insight in an interview for this report. "Our process requires us to get deep into operations – to be able to explain the value to a wide range of stakeholders," he added.

Such explanatory powers allowed Elliott to win a quick victory at Marathon Petroleum, which recently announced it would implement many of the activist's suggestions to enhance value at its master limited partnership, MPLX. Elsewhere, a campaign at Samsung

Electronics and holdout positions in XPO Europe and Ansaldo STS boost the average market cap of its targets to nearly \$26 billion, even though the size of the fund allows it to remain effective in the small and mid cap space.

"We don't aspire to a certain number of campaigns, but we do aspire to be consistent in our approach to each investment," Cohn explains. That means a playbook historically employed at small technology companies can be employed at consulting businesses, oil exploration and production firms and retailers.

All of which makes the outlook bright for this activist at least – something not lost on Cohn. "We don't see any overall decline in opportunities whatsoever," he concludes. "Some kinds of opportunities have gone away, but those have been replaced by others."

2 Starboard Value

Companies subjected to activist demands	8
Average target market cap	\$9.6b
Average annualized Follower Return	6.4%
<i>Activist Insight Online</i> news stories	200

By Starboard Value's standards, 2016 was a quiet year. In those twelve months it forced the sale many before it had failed to achieve at Yahoo, brought Office Depot and Staples together in a merger agreement that was only stopped by antitrust regulators, branched out into pharmaceuticals and even energy, briefly, for the first time, and successfully wound down its historic position in Darden Restaurants.

Overall, the number of companies at which it pushed for change rose from seven in 2015 to eight last year, and a less contentious approach also meant many demands went unreported.

Reports of a respectable set of returns for the year are borne out by Activist Insight's stock tracking Follower Returns feature. Although some stocks, such as Perrigo and Macy's, have struggled, other positions at Marvell Technology and Depomed have quickly earned profits.

In 2017, the big question may be whether Starboard continues pursuing the big names or pivots to smaller companies. In recent months it has increasingly focused on situations already in play, such as Stewart Information Services, Fiesta Restaurant Group and Cabela's. As a powerful broker, Jeff Smith's fund can play quite the role.



Yahoo played host to one of the year's highest profile activist campaigns

3 Carl Icahn

Companies subjected to activist demands	3
Average target market cap	\$26.3b
Average annualized Follower Return	4.3%
<i>Activist Insight Online</i> news stories	181

At the beginning of 2016 it seemed just as unlikely that veteran activist Carl Icahn would have a government role as he would be betting \$1 billion on the continued rise of stock markets. Yet the bearish investor made a bet on the presidential hopes of Donald Trump that gives him access lobbyists would kill for, and a role in picking crucial government appointees – including to the Securities and Exchange Commission and the Environmental Protection Agency.

If Washington business keeps Icahn busy, CEOs can rest a little easier. Icahn only made public demands at three companies in 2016, down

from seven the year before, and seemed to go easy on Allergan. There were notably few bright spots in his portfolio save for Chesapeake and Freeport-McMoRan, both of which were recovering from near-death experiences. As a result, Icahn's investment fund – 138% net short – was down 20% in 2016.

While many will be watching to see what happens with Herbalife, Icahn is likely to focus on integrating his automotive segment after taking Federal-Mogul private, stripping down American International Group, and potentially spying an exit from the separated Xerox companies.



Carl Icahn set his sights on board seats at AIG in January 2016

4 Corvex Management

Companies subjected to activist demands	3
Average target market cap	\$33.4b
Average annualized Follower Return	19.9%
<i>Activist Insight Online</i> news stories	60

In a year of distractions, Keith Meister's fund had an investment nightmare at Williams Companies, as merger partner Energy Transfer Partners elected to back out of a merger and as directors decided against pursuing alternative transactions. That left Meister fuming, to the extent that he filed papers to replace the entire board, but a handful of changes led to the former Icahn lieutenant dropping his demands.

Elsewhere, however, Corvex saw greater success. Bayer and Monsanto shareholders approved a combination of the two agrochemical giants, while Yum Brands completed the spin off of

its China division after giving Meister a seat on its board at the end of 2015. Meister's men were reportedly also pushing Time Warner to sell up but said little in public.

Going into 2017, Meister remains one of the most well-funded of the new generation of activists, and will likely want to see movement at portfolio company Pandora. Corvex also holds large stakes in Fidelity National Financial and Signet Jewelers, according to its latest disclosures. A quiet year by its standards in 2016 makes 2017 one for Corvex to show its mettle.



Corvex put pressure on Time Warner early in 2016

5 Gamco Investors

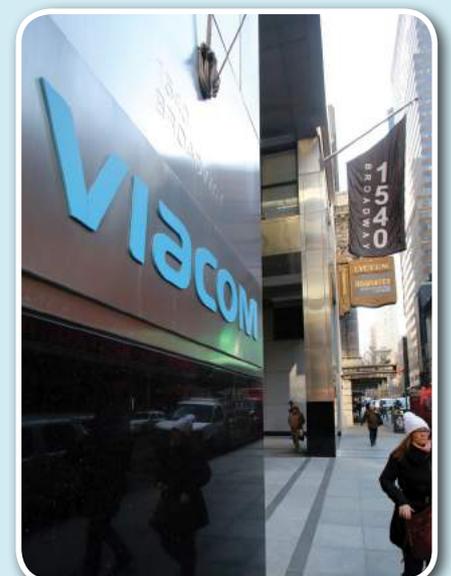
Companies subjected to activist demands	8
Average target market cap	\$2.9b
Average annualized Follower Return	31.0%
<i>Activist Insight Online</i> news stories	92

Gamco Investors matched the eight companies at which it made public demands in 2015 last year, proving there is little shortage of opportunity in the small cap range. Perhaps most notably, Mario Gabelli's firm was one of the few to stand up to Carl Icahn at Federal-Mogul Holdings, opposing a tender offer until the majority holder increased his offer to squeeze out minority holders from \$7 to \$10 per share – even though Gamco had asked for \$13.

Gabelli was also outspoken throughout the year at Viacom, and had less successful run-ins with Superior Industries International, where Gamco

lost its fourth consecutive proxy fight, and National Fuel Gas, which rejected Gamco's proxy access nomination on the grounds that the mechanism was only for shareholders who owned stock for the purposes of investment only, ruling that Gamco had sought to influence control of the company or its assets.

Gamco's stock picking was successful, however. Companies it made a public demand at rose 31% on an average annualized basis.



Gamco successfully sought the removal of Viacom's CEO in July 2016

6 Mangrove Partners

Mangrove Partners' first public appearance in the world of activism – excluding some vocal bearish calls – was a 2015 campaign at power generation company Atlantic Power, where the investment firm gained a board seat following behind-the-scenes negotiations. Clearly, Mangrove found the experience satisfying, and in 2016 it emerged as a busy activist, targeting five new U.S. companies, and reaching deals to nominate board members at three of them. In February, metallurgical coke maker SunCoke Energy appointed a new director suggested by Mangrove and in March, the investment firm started a battle for board changes at financial

services company Asta Funding. The dispute concluded in 2017, with Asta and its CEO agreeing to repurchase Mangrove's entire stake at a premium.

Also in the first half of 2016, Mangrove settled a proxy contest with patent risk manager RPX Corp, and was awarded the right to nominate a director at Fifth Street Asset Management. When in October Mangrove disclosed a stake in Peabody Energy, a coal miner under Chapter 11 bankruptcy protection, the company's share price increased more than eight-fold.

Companies subjected to activist demands	5
Average target market cap	\$407m
Average annualized Follower Return	90.6%
<i>Activist Insight Online</i> news stories	30



Mangrove Partners targeted Westmoreland Coal in November

7 Allan Gray

South African magnate Allan Gray announced in January that he had given his family's controlling stakes in his eponymous fund manager and its sister company Orbis to a charitable foundation, but the philanthropic move did not make the companies carrying his name any less combative. Allan Gray's South African and Australian investment firms pushed for changes to executive pay packages and opposed takeovers, among other things, on several occasions.

Allan Gray Australia's Chief Investment Officer Simon Mawhinney told *Activist Insight* for this report that he does not consider himself an activist, but always

holds discussions with its portfolio companies – engaging in fights only when drawn to it. “We don't invest in a company to orchestrate an outcome, but occasionally companies do silly things,” he says, adding that “a really good year for us would be a year when we don't have to throw punches.”

“Usually, when you are forced to act, it is too late,” Mawhinney adds, as shown by Allan Gray Australia's unsuccessful campaigns against the takeovers of Broadspectrum and UGL. However, the firm reportedly returned 34% in 2016 and, according to Mawhinney, won a lot of non-public battles.

Companies subjected to activist demands	5
Average target market cap	\$21.9m
Average annualized Follower Return	15.2%
<i>Activist Insight Online</i> news stories	26



Allan Gray engaged in talks with Foster's owner SABMiller over the merger with AB InBev

8 Amber Capital

Companies subjected to activist demands	8
Average target market cap	\$2.0b
Average annualized Follower Return	35.3%
<i>Activist Insight Online</i> news stories	17

Amber Capital has offices in London, New York and Milan, but as far as its activism-only fund is concerned, the focus is on Southern Europe, where most activists do not dare venture. Half of the assets are currently invested in Italy, and the rest is mainly split between France and Spain.

Amber's founder Joseph Oughourlian told *Activist Insight* that, in terms of returns, the biggest satisfaction in 2016 came from France, where cable maker Nexans surged almost 50% – two years after the activist succeeded in pushing for management changes – and Vivendi acquired Amber's stake in Gameloft in a hostile takeover. A busy year in Italy, with battles at Parmalat, Ei Towers and Ansaldo STS, among others, also paid huge dividends – literally, in Ei Tower's case.

"There is a lot to do in these markets. When it gets to pushing for changes to the management... it is complicated, but it pays," Oughourlian says, adding that "laws are extremely shareholder friendly, and stocks are currently cheaper in Europe than in the U.S."

9 Bulldog Investors

Companies subjected to activist demands	8
Average target market cap	\$167m
Average annualized Follower Return	7.9%
<i>Activist Insight Online</i> news stories	79

In 2016, Bulldog Investors was mostly true to its longstanding strategy of pushing closed-end funds to close their discount to net asset value – if necessary, by liquidating assets or launching self-tender offers. However, one of the activist's biggest wins came at Hill International, which awarded Bulldog three seats on the board, announced the resignation of its founder and chairman emeritus, Irvin Richter, and settled a lawsuit with the activist.

The dispute was a re-match of a 2015 contest, when the U.S. management services company defeated a Bulldog slate. "We put the most energies into this situation because of the lawsuit," Phil Goldstein, Bulldog's principal, said in an interview with *Activist Insight*. "Now everyone is rowing in the same direction. There have been positive operational developments."

As Goldstein puts it, closed-end funds are and will continue to be Bulldog's "bread and butter." In 2016, the activist won disputes at Virtus Total Return Fund, Nuveen Global Equity Income Fund and Crossroads Capital. "Moreover, public battles are only part of the story, with 60-70% of situations being settled without a fight," Goldstein says.

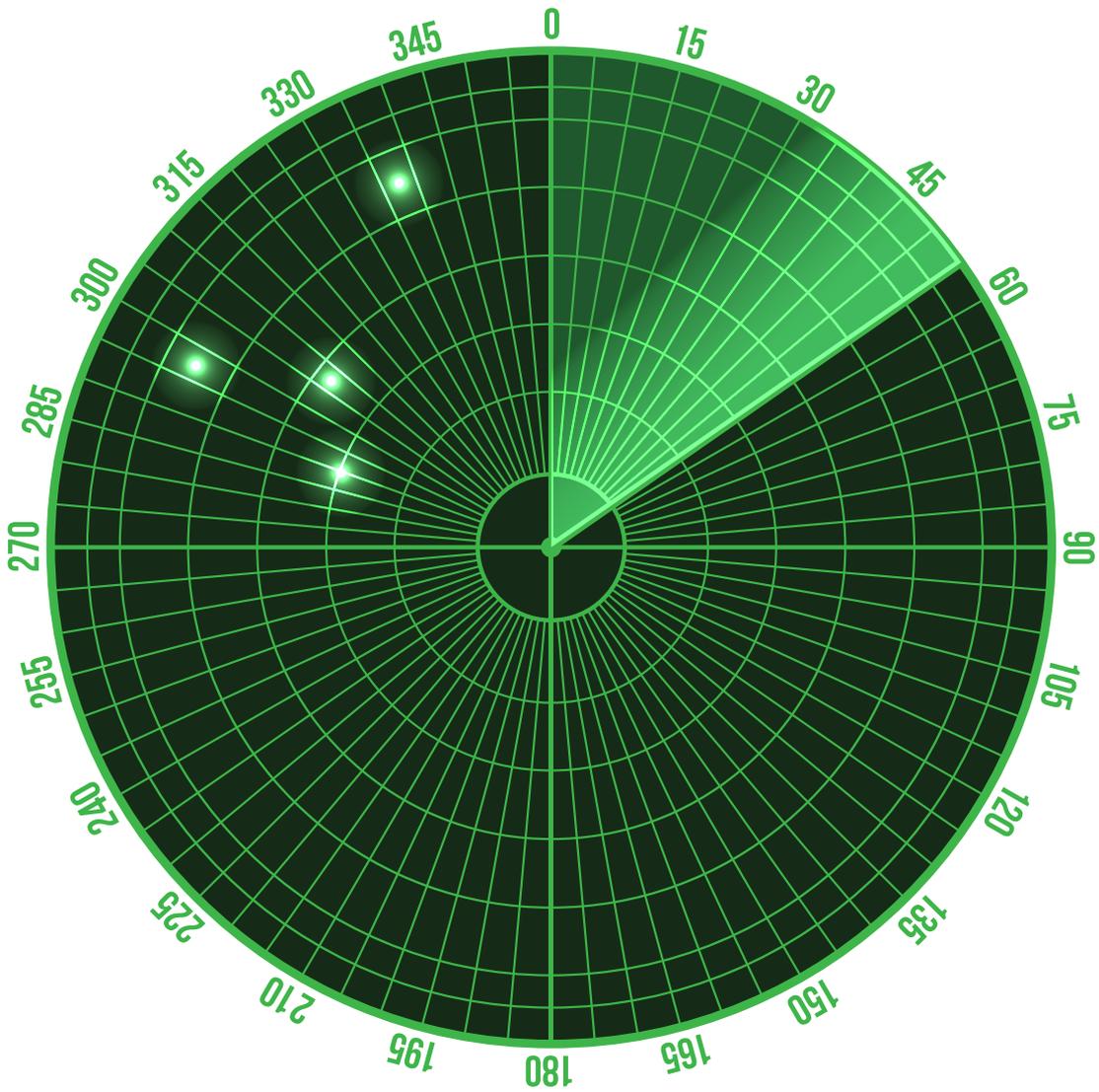
10 Teleios Capital Partners

Companies subjected to activist demands	3
Average target market cap	\$481m
Average annualized Follower Return	78.7%
<i>Activist Insight Online</i> news stories	10

Swiss activist investor Teleios Capital Partners is media-shy by activist standards, but made a name for itself in 2016. In March, it had a nominee appointed to the board of Norwegian auto parts-maker Kongsberg Automotive, after joining with two other investors to launch a proxy contest the year before. The dispute was the first time that Teleios – founded in 2014 – made public demands as an activist.

After that, the investment firm stayed silent for eight months, avoiding public exposure and sticking to its strategy of negotiating behind the scenes and seeking constructive dialogue with boards and management. During that spell, Teleios took positions in three British companies: McBride, Hogg Robinson Group and industrial belting firm Fenner.

In November, as required by U.S. rules, the activist revealed that it was engaging in negotiations with New York-listed Israeli company SodaStream International – which soon handed Teleios a board seat. In December, Teleios returned to the U.K., nominating a director at Fenner – which after initially opposing the request caved in and appointed him to its board.



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What now?

Cas Sydorowitz, CEO of Georgeson's Corporate Advisory Business, gives a step-by-step guide to dealing with an activist once they appear on your shareholder register.



Step 1: Profile the activist to determine what types of campaigns they have run in the past. Determine whether they work with any other investors and whether they are also invested. Are there any other activists on the list, whether or not they are known associates of the main actor?

Step 2: Don't ignore their request to meet. Respond similarly to how you would if any new shareholder were to appear on the list. In the first instance, organize the meeting with IR. Should subsequent meetings take place, they can be escalated accordingly. Keep detailed notes of your engagements with the activist, including when they took place, who was involved and what was discussed. Regularly consider:

- The source of the activist's information, to understand how they are deriving their assumptions;
- Who they consider to be your company's peers for relative performance? What time-frame do they consider when doing their analysis?
- Who their clients are and what type of lock-up periods they have. This helps indicate the time horizon they can work within (three- to five-year lock-ups indicate that they have time to ride out a campaign over several years, versus a hedge fund who has six- to 12-month redemption windows).
- Whether they intend to increase their stake, and if so, what price marks a "buy" opportunity, in their models?

Any presentation or notes they provide will indicate what they are after and how they expect to unlock value in the company.

Step 3: Escalate all information gathered, in terms of presentation material, to the CEO and the board. Make sure the preparation team is informed and brought together after appropriate internal review. The ideal team should include your lawyers, financial advisers, PR firm and proxy solicitor. "Peacetime" advisers don't always make the best "wartime" advisers.

"Avoid the point/counterpoint debate in the media. Most investors just want the controversy to go away and the focus to return to the business."

Step 4: Think like the activist. How is your financial performance against the market and the peer universe? Is there market consensus over who the peers should be? What is the narrative around your performance? Is this a short-term anomaly or a sign of a more endemic issue? What do your long-term shareholders think? Are there underperforming divisions, or markets?

Step 5: Take an inventory of your shareholders. When did you meet with

them last and in what context? What types of shareholders are rotating out of and into your stock? Does the team understand why that is? If there are other known activists, how long have they been there? What is the feedback from your shareholders about strategy, financial performance and the links to the company's remuneration plan?

Step 6: Conduct your own board and governance analysis to determine what an outside-in perspective may be. Consider the governance policies of your largest shareholders, along with the main proxy advisers, ISS and Glass Lewis.

Step 7: Don't assume anything. An activist's comment about one director does not necessarily say anything about the other directors.

Step 8: Don't take it personally. Activism is about unlocking value and individuals on the board represent levers that can create further value for the activist. Avoid the point/counterpoint debate in the media. Most investors just want the controversy to go away and the focus to return to the business. Your shareholders expect you to act with integrity and transparency.

Step 9: Make sure Georgeson is one of your wartime advisers!



Would you make the right moves?

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- Assessing the voting risk of the institutions and proxy advisors' influence
- Weighing up the influence of the retail holders
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Activism booms outside the US

The number of companies facing public activist demands outside the U.S. surged to 302 in 2016, up from 255 a year before, driven by greater interest in Asia and opportunities created by volatile European currencies. Paolo Frediani reports on the international expansion of activism.

Activism outside the U.S. exceeded expectations in many regions in 2016, with the number of public targets surging despite the preference for privacy in European and Asian countries, where investment communities are averse to public spats, shareholders do not have stringent disclosure requirements for their plans, and most activism takes the form of behind-the-scenes negotiations.

The number of European companies publicly facing activist demands in 2016 reached 97, up from 72 in 2015, and in Asia it rose to 77, up from 52 in 2015. The growth in these regions compensate for stable activity in Australia and a slowdown in Canada. In percentage terms, the number of companies in the crosshairs of activists outside the U.S. reached 40% of the total in 2016, up from 38% in 2015 and 35% in 2014.

Event-driven Europe

The U.K. has always been at the forefront of European activism, and 43 companies publicly targeted in 2016 had their headquarters in the country – up from 27 in 2015.

The outcome of the Brexit referendum in June did not scare activists away. Instead, London-based RWC Partners and U.S. activist Livermore Partners said in interviews with Activist Insight that Brexit made potential targets cheaper. Livermore's David Neuhauser added that the increased uncertainty will force British companies to seek ways to unlock shareholder value, creating opportunities for activists.

In Germany, where the number of companies targeted rose from a six-year nadir of two in 2015 to nine in 2016, and in

Italy, where it rose from six to 12, the surge was partially correlated with the increasing presence of foreign institutional investors in the two countries. In the second half of 2016, governance adviser CamberView Partners boosted its European office, and the firm's new managing partner for the region, Jean-Nicolas Caprasse, told Activist Insight that Continental Europe has seen an increased presence of institutional investors from the U.S. and the U.K. – ideal interlocutors for activists.

Along with established activists Elliott Management and Amber Capital – both extremely busy in Europe in 2016 – Swiss investment firm Teleios Capital Partners disclosed a series of activist positions in the U.K., Active Ownership Capital and The Children's Investment Fund Management waged historic campaigns in Germany, and British institutional investors such as Standard



“The number of European companies publicly facing activist demands in 2016 reached 97, up from 72 in 2015, and in Asia it rose to 77, up from 52 in 2015.”

Life Investments, Royal London Asset Management and Hermes Investment Management were often vocal with their portfolio companies.

The Asian boom

In Japan, the number of companies targeted by activists increased from nine in 2015 to 15 in 2016. The Japanese surge was expected by many, as favoring shareholder activism was part of Prime Minister Shinzo Abe's plan to revive the country's economy. In Singapore it increased from nine to 12, in China from eight to 11 and in South Korea from two to five – with Elliott Management once again waging a high profile campaign at the Samsung group.

David Hurwitz of SC Fundamental – which operates in South Korea in tandem with local activist Petra Capital Management – told Activist Insight that dissident investors in the country had been helped by increasingly loud calls from market participants, including the government and the State pension fund

National Pension Services, for better capital allocation at listed companies – which tend to hold huge piles of cash.

Dektos Investment's Roland Jude Thng and Quarz Capital Management's Jan Mörmann, two activists operating in Singapore, said in interviews with Activist Insight that excess cash is often an issue in Singapore too, and that the poor performance of the stock market, the undervaluation of several companies, and cultural changes are making shareholders more demanding.

As for China, most of the companies targeted by activists are listed in the U.S. or Hong Kong, due to a larger mass of institutional investors outside the mainland, according to activist Peter Halesworth, the head of Heng Ren Investments. However, in an interview with Activist Insight he said, “Some of the most energetic and clever activists that we have met are Chinese and living in China. They are very sensitized to their rights, and know a bad deal when they see one.”

In India, a battle between Tata Group's patriarch Ratan Tata and Cyrus Mistry, the chairman of several of the conglomerate's portfolio companies, brought U.S.-style governance battles to the attention of the financial press for months.

Australia, and Canada's slowdown

The global surge in activism in 2016 was not driven by the basic material sector, where the number of companies targeted rose by just one, to 119, from 2015's total. Difficulties faced by natural resources companies made activists less willing to engage in campaigns in Canada and Australia, where miners and oil and gas firms have traditionally been their favorite targets. In Canada, only 49 companies faced public activist demands in 2016, down from 60 in 2015. In Australia there were 60 targets, up from 59 a year before, and only 48% in the basic material sector, against 64% in 2015. That said, Australia has almost twice as many targeted companies per inhabitant than the U.S., while Canada does not lag far behind its neighbor. 🌐



2016: the year in numbers

A wider spread

Activism grew fastest in Asia and Europe in 2016, with North American volumes supported by one-off U.S. campaigns amid a slowdown in Canadian and dedicated activist activity. As the data show, the number of companies publicly subjected to activist demands are generally on the rise, while becoming more diverse and less predictable.



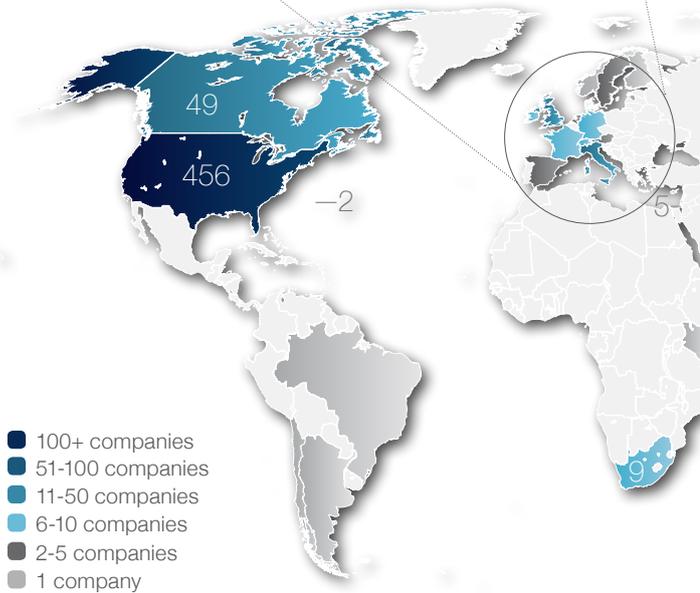
Spotlight on Canada

Companies publicly subjected to activist demands in:

2016: 49
2015: 60



Canada saw one of the sharpest drops in activism in 2016, likely due to the weight of the energy sector in a low oil price environment. As this graphic shows, the reduction in the number of basic materials companies publicly subjected to activist demands accounted for half of the total difference between 2015 and 2016.



- 100+ companies
- 51-100 companies
- 11-50 companies
- 6-10 companies
- 2-5 companies
- 1 company

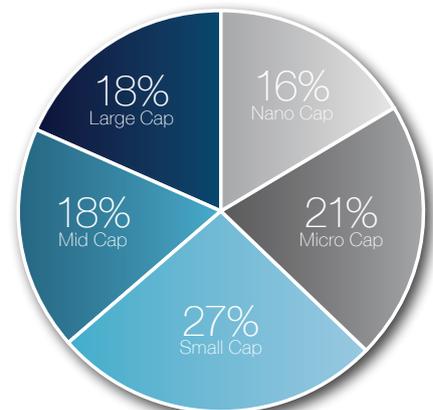


Spotlight on US

2016: 456
2015: 418



Of the U.S. companies publicly subjected to activist demands in 2016, those with a market cap of \$10 billion and above saw the biggest change in activism volumes, down three percentage points compared to 2015.

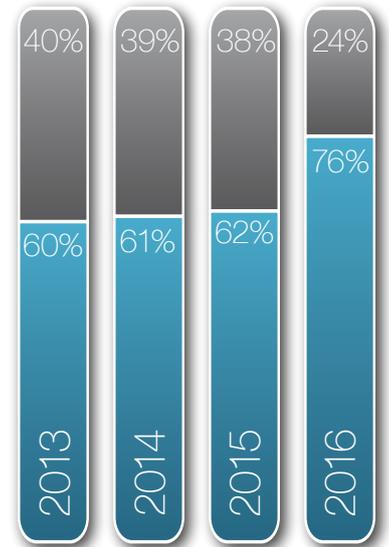


Breakdown of U.S.-based companies publicly subjected to activist demands in 2016 by market cap.



Spotlight on Europe

2016: 97
2015: 72



Much talk of activists being attracted to Europe from overseas has obscured the rise of a home-grown scene. Of the investors making public demands at European companies in 2016, nearly eight out of every ten are based in Europe. Throughout the year, Europe-based activists targeted some big names, such as Volkswagen, ABB, and Euro Disney.

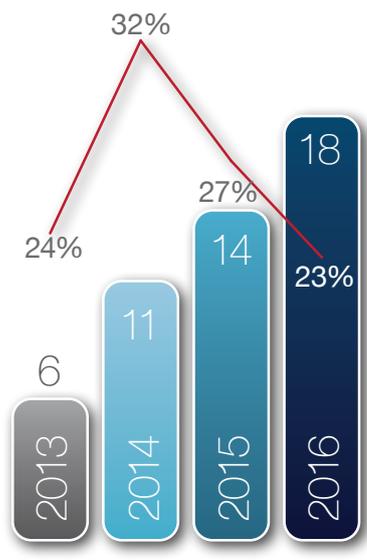


Spotlight on Asia

2016: 77
2015: 52



Proportion (%) of activists making public demands at Asia-based companies, who are classified by Activist Insight as having a primary or partial focus on activism

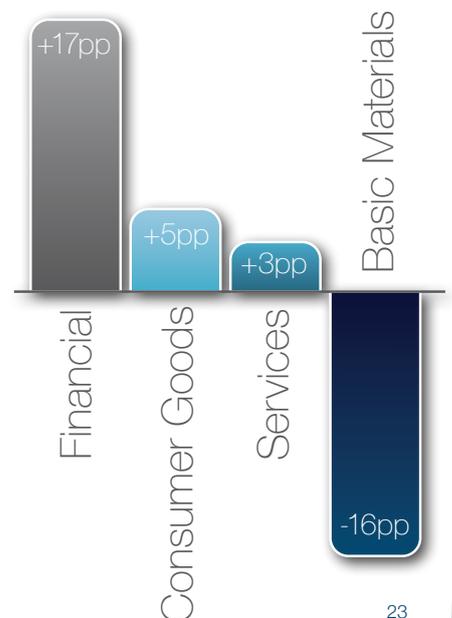


The total number of investors who regularly use activism as part of their investment strategy played their part in increasing the volume of activism in 2016, but their contribution declined to less than a quarter of the total number of companies targeted for the first time since 2013, indicating a substantial rise in the number of one off activists.



Spotlight on Australia

2016: 60
2015: 59



Like Canada, Australia saw a big drop in the number of basic materials companies targeted by activists in 2016 compared to 2015. However, overall volumes remained consistent, thanks to a boom in the financial and consumer goods sectors.

Runaway market

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An interview with Marc Weingarten and Eleazer Klein, co-chairs of Schulte Roth & Zabel's global Shareholder Activism Group.

We started the year worrying about smaller activists and whether they would survive, but it's the bigger names that have been quieter in 2016. Have they struggled to adapt, given their size?

Marc Weingarten: For some of the major players, 2015 returns weren't great, and returns for the first half of 2016 weren't very great either. Some had to deal with redemption requests, and I think that contributed to the reduced level of activity. But several of the leading activists, including particularly Elliott and Starboard, remained very active in 2016. Overall, there was a sustained level of activity compared to the prior year, but less splashy, with fewer mega cap campaigns.

Eleazer Klein: Some of the bigger players have been balancing their time between managing their portfolios and looking at targets. In addition, the market's general positive performance has masked some large cap opportunities. But that market segment will come back again.

Has it been a busy year? Who kept you busiest – newcomers or established activists?

EK: Yes, and both. Traditional players have been very active. Newcomers continue to take up activism, seeing that it has been a successful strategy for creating value. Instead of doing what they have traditionally done when frustrated with the performance of an investment, which was to take their losses and sell, they see that there is a way to try to make some changes.

That's what is driving most occasional activists. The ones we've worked with — they've been in the stock for a long time, they've spoken to the company repeatedly, and the companies don't do anything to address their performance issues. Investors can continue to be frustrated or they can say, "Hey, this strategy seems to be driving change, let's do it."

"Newcomers continue to take up activism, seeing that it has been a successful strategy for creating value."

There's been talk of institutional investors stepping up and being more active. Is that a trend we're likely to see more of?

MW: There's a question over whether traditional institutional investors will get more involved with activism. We've worked with a number of them, such as T. Rowe Price, this year. Will it be a major trend? I think it will be a slow build but we do see these institutional investors building up their internal governance teams and getting more engaged with the companies they invest in. Sooner or later you will see them getting more active.

How have the targets of activism changed this year?

MW: I think there was some reduction this past year in mega cap and even in large cap campaigns, with more activity in the mid cap and smaller sectors. The

large cap space has been somewhat picked-over, there are far fewer large cap companies than mid and small cap, and, to some degree, large caps have gotten their act together. They've realized that activism is here to stay, and many have proactively taken the steps to enhance shareholder value that an activist otherwise might have sought.

Have companies been much more defensive this year, perhaps because of the support from institutional investors?

EK: While some of the institutional investors have talked about being more reluctant to support activists, or at least being more selective in their support, I haven't seen much of a change in the practice. Many of the institutional investors have been reluctant to embrace change but I haven't seen companies feel much more empowered because of that. Companies are examining campaigns more closely and checking more frequently with the institutions to see what they want, but that doesn't change the facts at a company that has performance issues and where there is a legitimate complaint from a credible shareholder.

Did anything surprise you about the Shareholder Activism Insight survey?

MW: I was a little surprised that people thought there was so much opportunity in Europe outside of the U.K. I understand that weak markets would offer value opportunities, but very few activists have the bandwidth to go after European targets. They're not as familiar with the

“Companies are examining campaigns more closely and checking more frequently with the institutions to see what they want, but that doesn’t change the facts at a company that has performance issues and where there is a legitimate complaint from a credible shareholder.”

shareholder base, the different legal environment or the cultural roadblocks. There may be a value gap there, but I was surprised that many activists thought that they might pursue opportunities in those regions.

[What do you make of proxy access, now that we’ve seen a couple of nominations?](#)

EK: We said on day one that proxy access was simply “window dressing” by companies trying to appear to care about shareholder rights. What I liked about Gamco at National Fuel Gas is that it highlights that this is nonsense. The almost standard proxy access bylaw has been drafted to virtually assure that it will never be used. The rejection of Gamco highlights that companies don’t put proxy access in place to allow shareholders to use it, but instead for shareholders to see it. Companies aren’t really interested in letting “active” shareholders have a say. At best, they are willing to let shareholders, who have no objection to how they’re running the company, have a say.

[Donald Trump – good or bad for activism?](#)

MW: Well, he’ll probably be good for M&A. The Democrats have traditionally been a lot tougher on antitrust. A more active M&A market is usually good for activism, as it makes it easier to push companies into sales and acquisitions,

particularly in industries in need of consolidation, which activists advocate. However, if there are a majority of Republican commissioners at the SEC, they may revive closing the 13D window.

EK: It’s hard to predict how these things translate and filter down. We’ve been talking about closing the 13D window for years, and for all the expressed views wanting to close that window, there’s a lot of weight behind not doing it. I know we’re biased, but there are a lot of valid reasons why the window should be left as is.

MW: Trump and the Republican agenda are clearly very pro-business, and that’s likely to mean they’ll be anti-activist. Also, if the market continues to perform so strongly, that could take a lot of targets out of play. But if companies are able to repatriate offshore cash following changes to the tax regime, that could reinvigorate buyback campaigns, which had somewhat run out of steam.

[Any other predictions for 2017?](#)

EK: I would expect it to be a busy year. Some of the players that were on the sidelines in 2016 will be active again, in addition to the current players. More of the occasional activists will continue to seek change. M&A activism will continue to be a factor. It should be busy and interesting.

An interview with Jim McNally, Schulte Roth & Zabel London-based partner advising on shareholder activism matters.

[What does Brexit mean for activists?](#)

Jim McNally: It’s too early to tell. Whilst we learned in mid-January some of the high-level negotiation objectives of the British government, we can only guess as to how those might pan out over the two-year negotiation period. But that also gives us some opportunity for those who are able to identify and react to the coming developments ahead of the pack. Activists need to think about what Brexit means for their own businesses, as well as those businesses which they may be invested in or monitoring for potential investment.

[There was more activism in Europe in 2016, but were activists any more successful?](#)

JM: I don’t think there has been any big shift from 2015, but we are seeing activists needing to show perhaps a little more mettle. Persistent persuasion is not always enough, and there is ever more competition in the strategy, particularly with an increase in those willing to employ the strategy on a non-exclusive basis.



Marc Weingarten



Eleazer Klein



Aneliya S. Crawford



Jim McNally

Diminishing returns

The number of board seats won by activist investors has fallen from its 2014 peak and management teams have gained the upper hand in contested votes. Ben Shapiro analyzes settlements and proxy fights in 2016 and the outlook for the year ahead.

As the number of activist situations has risen over the past half-decade, the prominence of the strategy has enabled both issuers and investors to understand its capabilities and limitations, to the point that the two sides have generally avoided its most costly byproduct, proxy contests.

“Under today’s system, investors are put to a hard choice, fully support status quo, or vote on any, or some amount of change.”

After two years in which more than half of demands for board seats settled before a contest, 2016 saw 63% settle early. That percentage has been on the rise since 2012, and represented a major jump from 2015, when activists and companies settled without a public spat 54% of the time.

“Management teams and boards are becoming more sophisticated and actually appreciate the value that shareholders that have a long term view can add,” said Chris Teets, partner at Red Mountain Capital Partners. “There is certainly a heightened willingness to settle between shareholders and management teams, and it tends to be the most egregious cases when you tend to see the fights.”

At the 212 U.S. companies where activists sought board seats in 2016, only

65 companies opposed nominations, and of those nearly one-third settled later in the process. Yet, while 2012 and 2013 saw the outcomes of shareholder votes go mostly to the activists, the advantage reversed in 2015 and 2016 – last year dissidents won at least one board seat in nine contests, to 13 clear sweeps for management, including one for Roomba-maker iRobot over Red Mountain.

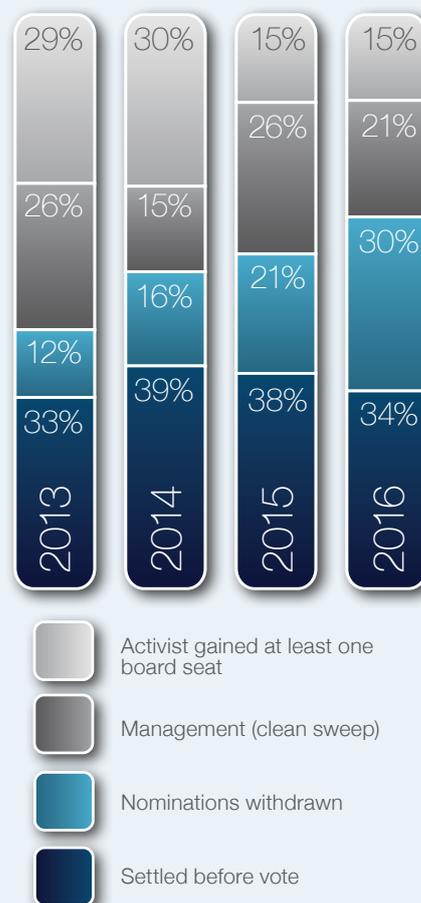
While the total number of settlements has risen in recent years, investors are gaining fewer board seats overall. Where at least partially successful, activists gained 1.5 seats per company in 2016, on average, compared to 1.7 the year before and over two in each of 2013 and 2014. The trend may be attributable to a higher frequency of withdrawals, as investors make optimistic demands and then walk away from a fight after a company calls their bluff. Some 30% of contests saw activists withdraw their nominations in 2016, compared to 21% in 2015 and just 12% in 2013.

The combined effect of increased withdrawals and issuers becoming more adept at shutting out investors can be seen in the declining number of board seats gained by activists each year. After activists gained a record 276 board seats in 2014 at just 154 companies, they were only able to accrue 215 director positions in 2016 despite launching 212 campaigns aimed at board representation.

It may only get worse, according to Luma Asset Management Founder Greg Taxin, who is confident the universal ballot, which would force companies

to issue a single proxy card containing both its director candidates along with the dissidents’, will be approved in late 2017. The hedge fund manager admitted the rule will not be implemented until next proxy season, but unlike most investment managers, he believes it will be detrimental to activists.

Outcomes of proxy contests at US-based companies since 2013



N.B. 1. All percentages are given to the nearest whole number, and may cause rounding errors

“The combined effect of increased withdrawals and issuers becoming more adept at shutting out investors can be seen in the declining number of board seats gained by activists each year.”

“Under today’s system, investors are put to a hard choice, fully support status quo, or vote on any, or some amount of change,” said Taxin. “Because most companies that go to fight are well chosen by dissidents, investors vote on the dissident card, and in doing so starve management of votes, because they can’t mix and match.”

Taxin went on to say that under the universal ballot, investors will naturally give votes to management in addition to

voting for one or two members of the dissident slate. The change would be beneficial to issuers, which would more often avoid comprehensive defeats at the hands of activists.

“I ran three proxy fights for a majority of the board and won all three times. Part of the reason I won is because they wanted some amount of change and voted on my card, and management got no votes,” said Taxin said Taxin, who serves as an adviser on a number

of activist situations. “They all voted for mine, because no one voted on management cards, and that wouldn’t happen on the universal ballot.”

Taxin’s victories were not indicative of his peers’ success in 2016, and perhaps the pendulum will swing back in their favor in the 2017 proxy season. Four activists have already gained board representation in 2017 and several have threatened to go all the way to a vote as annual meeting season begins. 📌

An interview with Michael E. Swartz, Schulte Roth & Zabel partner advising on shareholder activism litigation handled by the firm.

ValueAct Capital Partners was sued by the Department of Justice this year for violating the Hart-Scott-Rodino Act (HSR), which requires investors to seek clearance when buying more than \$78 million of stock unless they have merely passive intentions. How cautious must activists be in relying on the passive exemption?

Michael E. Swartz: Activists should be quite cautious in this area. The complaint filed by the Justice Department, and the consent decree that subsequently was entered, show that the Federal Trade Commission and Department of Justice have taken a very narrow view of the “passive investor” exemption to filing for HSR, which applies to acquisitions up to 10% of the company’s voting securities where the purchase is “solely for the purpose of investment.”

Activists need to take into account that one of the factors the Justice Department cited when arguing the passive exemption didn’t apply to ValueAct was the fact that it is an activist

fund and marketed itself as such. When making this assessment, funds should take into account their potential future strategies with respect to the issuer, since later conduct may be offered as evidence of non-passive intent at the time of acquisition.

Have there been any new litigation tactics against activists?

MS: Yes. Under Section 16(b) of the Securities Exchange Act, which is the short-swing profit rule, directors, officers and beneficial owners of over 10% of an equity security of an issuer must disgorge any profits from purchases and sales of securities within a six-month period. Typically, for investors, the short-swing profit rule comes up only when they are a 10%-or-greater holder.

However, as the short-swing trading rule also applies to directors, plaintiffs’ lawyers have taken the position that investment funds – activists, in particular – who appoint members of

their funds as directors on corporate boards, are now functionally serving as directors by “deputization.” So, regardless of whether the fund is over 10%, if any purchases or sales are made within six months, these plaintiffs’ lawyers take the position that the fund’s trades were done by a director (as deputy for the fund), and therefore, all profits by the fund are disgorgeable if generated within six months. We’ve seen a couple of those cases recently and we expect to see more – that’s something that activists need to take into account when deciding whether to trade and in structuring how they interact with their appointees to boards of public companies.



Michael E. Swartz

Reflecting and anticipating

Bob Marese and Paul Schulman, managing directors at MacKenzie Partners, discuss the activism and corporate governance trends that defined 2016, and what to expect in 2017.

There were relatively few activism campaigns at large cap companies in 2016, as activists seemed to increasingly favor small cap targets. What do you see as the biggest reasons for this shift?

Bob Marese: Increasing competition from new entrants to the activism-space may be causing some crowding among large and mid caps – of which there are fewer to begin with – forcing activists to look to small caps for opportunities.

Paul Schulman: There are a limited number of large companies with the kind of valuations, performance issues, and governance structures that activists find attractive. On the other hand, there are a lot of small cap companies out there, and many of them are particularly vulnerable to activists for a variety of reasons.

BM: Small and micro cap companies tend to lack the extensive governance and IR infrastructure that a large cap or mid cap company may have in place. From a practical standpoint, it becomes much more burdensome for these issuers to effectively, both from a cost and productivity standpoint, respond to activists. As a result, many activists view the likelihood of a settlement as rather high, which further encourages activity at these companies.

The number of campaigns from first-time and occasional activists increased fairly dramatically in 2016. What were some of the reasons behind their rise? Do you expect a similar showing in 2017?

BM: Historically, the activism space has been dominated by a relatively small number of well-known hedge funds. However, these frequent activists were overshadowed in 2016 by first-time and occasional activists, which drove a lot of the activity. We fully expect more activism from first-time or occasional activists in 2017.

PS: All fund managers typically share an interest in increasing their AUM. In many cases, the endgame for the first-time activist is to secure a board seat and notch a quick victory, which it will then use to build its brand and tout its track record when establishing a new fund or expanding an existing one. Many fund managers have also been attracted by the alpha generated by some activists over the past several years and adopted a more activist-oriented approach over time.

How has the recent rise in M&A activism affected the environment for deals in 2016? Is this type of activism likely to continue?

PS: With any transaction, depending on the deal structure, you have to make your case to shareholders that the deal will either create long-term value or provide an attractive enough premium to warrant their support. But with the

fairly significant increase in anti-deal activism or bumptrage, it forces issuers to thoughtfully and fully communicate the merits of the deal to investors.

BM: It remains to be seen how the markets will respond to the new administration, and much will depend on whether or not certain initiatives, such as a cash repatriation tax holiday, are carried out. But if the markets and corporate earnings continue to rise, we would expect to see pro-deal activism increase. Conversely, if markets respond negatively, we could see more activism directed toward blocking, or agitating for better terms in, deals in progress, particularly in situations where there is a substantial equity component to the merger consideration.

2016 was a record year for settlements, but there has been some indication that certain institutions – notably State Street, as evidenced by its public letter – are pushing back. How is the current climate among shareholders likely to shape settlement negotiations in 2017?

PS: The State Street letter confirmed what we had been increasingly hearing from some institutions recently: that they would often prefer to have the opportunity to vote on the composition of the board, as opposed to having the process privately negotiated between the board and one shareholder, whose interests may not always be aligned with their own. The State Street letter could embolden some issuers to resist settlement in certain situations.

“Frequent activists were overshadowed in 2016 by first-time and occasional activists.”

“The State Street letter confirmed what we had been increasingly hearing from some institutions recently: that they would often prefer to have the opportunity to vote on the composition of the board, as opposed to having the process privately negotiated between the board and one shareholder.”

BM: Each situation is unique, and much depends on the overall composition of the issuer’s shareholder base. A shareholder base heavily weighted with active governance investors may cause management and boards to forgo a settlement and bring the board composition decision directly to all shareholders through a vote.

Proxy access continued to play a major role in corporate governance discussions in 2016. How has the conversation around proxy access evolved in light of the events at H&R Block and National Fuel Gas?

BM: Proxy access is now widely regarded by many shareholders as a fundamental right. Though there were slightly fewer proxy access proposals that went to a vote in 2016, new points of contention emerged. While almost everyone has coalesced around the 3%/3 year standard, the question now is not whether or not to adopt proxy access, but on what terms and with what limitations included in the more detailed provisions.

PS: The H&R Block situation illustrates that, although the SEC may be reluctant to grant no-action relief to companies seeking to exclude a 14a-8 proposal to amend an existing proxy access bylaw, shareholders tend to grant companies some leeway in filling

in the margins of their proxy access provisions, so long as they largely adhere to the market standard. Proxy access will remain at the forefront of corporate governance this year.

BM: The effects of the National Fuel Gas situation have yet to fully play out, but the early signs suggest that, for proxy access bylaws that contain similar language, their utility for activist shareholders will be extremely limited. That said, most activists will continue to seek board representation via negotiated settlements and proxy contests, rather than proxy access.

The universal ballot appeared to gain some momentum in 2016, with the SEC issuing long-awaited proposed changes to the proxy rules requiring the use of universal proxy cards in contested elections. Will we see the universal ballot in action in 2017?

BM: Even if the proposed rules were adopted, they would not be in effect for the 2017 proxy season. And, like other legislative initiatives, it’s still unclear what effect the new administration might have on the universal ballot. What is apparent is that, with the forthcoming departure of SEC Chair White, the universal ballot is losing a keen supporter, and it seems unlikely that her replacement will share her enthusiasm.

PS: However, there is clearly institutional momentum behind the universal ballot, and we believe that it will actually benefit management in many situations. We suspect that it will become widespread eventually, but we may need to wait a bit longer.

About Mackenzie Partners

Mackenzie Partners is a full-service proxy solicitation, investor relations and corporate governance consulting firm specializing in contested solicitations and M&A-related transactions.

We focus on serving our clients in their extraordinary transactions, and have been involved in many of the largest and most significant mergers, tender offers and proxy contests over nearly three decades.

We’re confident that our team approach is the right solution in today’s complex and changing market. Our skill, experience, and dedication to our clients are the reasons that our professionals have become trusted advisers to investors, boards, and management teams.

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Spread betting

Activist short sellers have grown in prominence on the back of some notable successes despite rising markets, especially in North America. Claire Stovall examines how they broke new ground and targeted new geographies in 2016.

Over the past couple of years, we've watched activist short calls grow from a relatively unknown phenomenon to target 112 companies in 2013 and a whopping 205 in 2015, according to Activist Insight data. The question on all of our minds was whether activist short sellers' momentum would continue at an equally fast trajectory. In fact, 2016 saw 193 companies targeted, slightly lower than the year prior. And, instead of adding to their campaigns at home, several prominent short sellers this year turned to new markets and began a year of laying the foundations for short campaigns to come.

Eyes on Asia

Most notably in 2016, activist short sellers flung open the doors to Japan, beginning with Well Investments Research's campaign at Marubeni in December 2015. Well Investments went on to launch campaigns at three more Japanese companies in 2016.

It wasn't long until prominent short sellers Muddy Waters Research and Glaucus Research took notice, each announcing an activist short campaign of their own; Horseman Capital Management and Oasis Capital Management also unveiled Japanese shorts in 2016, bringing the campaign from zero in late 2015 to a remarkable 11 by the end of 2016.

Discussing his turn to Japan, Well Investments' Yuki Arai credited the country's new focus on corporate governance as an opportunity to take

a fresh look at mispriced assets. This attitude may have spilled over into the rest of the region; South Korea saw its first activist short less than three months after Arai first published in Japan, with the launch of Ghost Raven Research's campaign at \$10 billion biologics company Celltrion. The next month, we followed the first activist short campaign in Taiwan when The Street Sweeper discussed Himax Technologies.

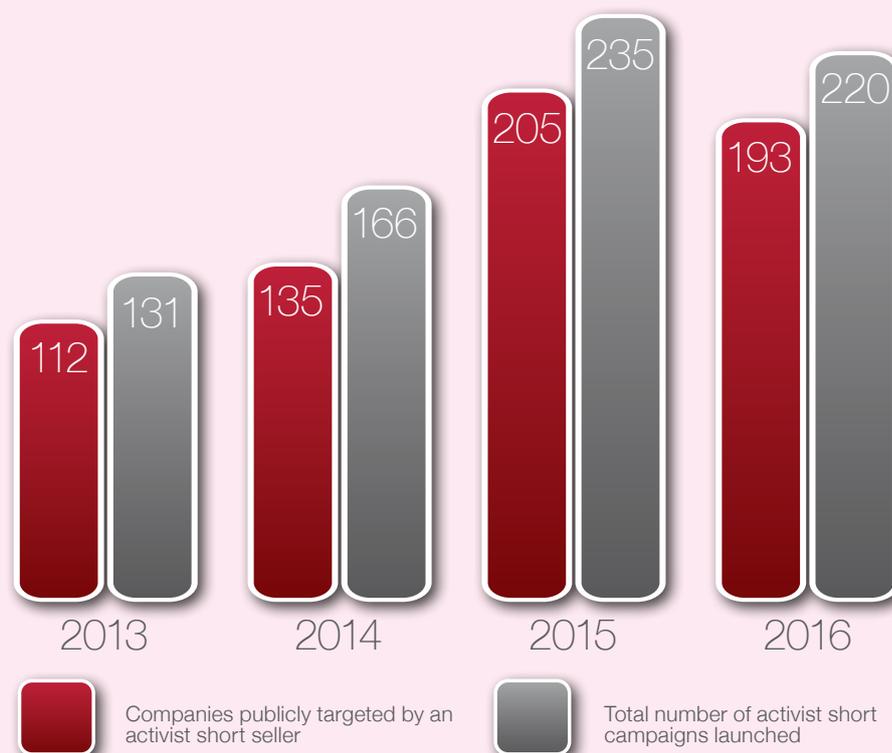
Beginning a long road

Citron Research's Andrew Left is a big exponent of short selling in Asia. When questioned on where he and his kind will look for opportunities in 2017, Left

was decisive: "There is a lot of fraud in Japan," he notes. Yet for Citron, Hong Kong, the favored domain of activist short sellers for several years, "is pretty closed," after 2016 saw Left found guilty of using "sensationalist language" and making false claims – a verdict he says sanctioned him "for telling the truth." Hong Kong is "still a different kind of market," he argues.

Other prominent activist shorts seem to disagree. Anonymous Analytics wrote in a July report for *Activist Shorts Research*, before its acquisition by Activist Insight, that the road ahead for Hong Kong to clean up "remains long and will be littered with the corpses of more fraudulent

Companies targeted by activist short sellers and total campaigns



“Once Japan learns that activist shorts actually add value, there is going to be a lot of opportunity there for shorts.”

companies to come.” Muddy Waters’ Carson Block is on the same page, having promised in December to seek out more Hong Kong targets on concerns of stock manipulation.

GeolInvesting, which has launched campaigns at over 30 companies in China and Hong Kong according to Activist Insight data, also pledged in March to continue cleaning up China based fraud – most recently combining with long activist Heng Ren Investments to air allegations against Sinovac Biotech.

But Left hopes Japan will be different. “With Abenomics, we’re closer and closer to cracking Japan,” he said. “Japan has been a very closed system for years. The shorts haven’t really worked it out to where they should, but once Japan learns that activist shorts

actually add value, there is going to be a lot of opportunity there for shorts. But in the long run, that’s going to be very good for their markets.” Left added, “It’s a cleansing process.”

Shorts go global

Companies outside of Eastern Asia haven’t escaped scrutiny. The year also saw the first campaign at a Bahamas-headquartered company, with Richard Pearson targeting Nymox Pharmaceutical.

Further, Muddy Waters’ Block came through on his Fall 2015 promise to target the “ticking time bombs” of Western Europe, following a theme for 2016 of shorting heavily financially engineered companies. After the activist’s October 2015 short of \$24 billion Swedish telecom

company TeliaSonera, as well as its December 2015 short of French grocer Casino and Casino’s parent company Rallye, Muddy Waters delivered our second German short of 2016 with a campaign at media company Ströer in April.

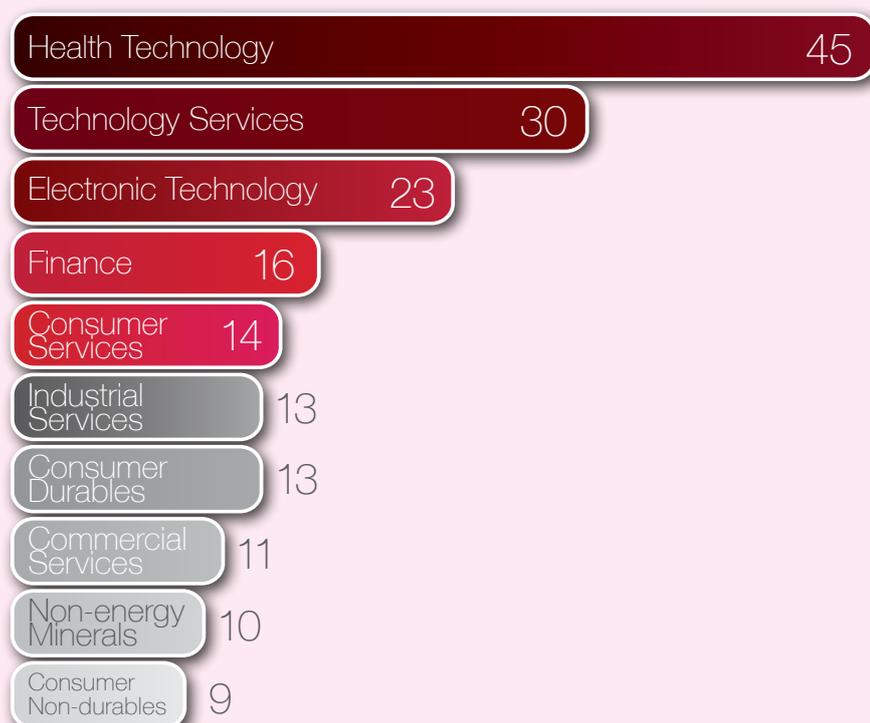
However, beating Muddy Waters to the punch in Germany, which had not seen activist short activity since 2013, was a new, anonymous short seller called Zatarra Research & Investigations. The activist launched a relentless campaign in February against \$6 billion payments company Wirecard, which saw a regulatory inquiry, the rise of an anonymous whistleblower and comments from noted short seller Bronte Capital, as well as reported legal action against both the short seller and the company.

Where to next?

At the same time, other activist shorts continued pursuing some of their most reliable targets. For the fourth year in a row, health technology companies were the most popular sector for shorting. Following Valeant Pharmaceuticals in 2015, activists such as Citron Research kept the conversation in 2016 focused on pharmaceutical and biotechnology companies, including targets such as Express Scripts and AveXis.

Speaking with Activist Insight on shorts’ interest in health technology companies, Andrew Left of Citron Research noted that “the mega trend is ‘banks are the new pharma, and pharma is the new banks.’” He added that “any pharma company that has built its business on raising prices is gone.”

Most targeted sectors by activist short selling campaigns in 2016



The short top five

Out of the 70 total activists behind the 220 short seller campaigns launched in 2016, we are highlighting the top five, ranked based on average campaign length return, number of campaigns, strength of allegations, company responses, regulator responses, and average market capitalization at announcement of targeted companies.

1 Glaucus Research

2016 campaigns	4
Average 2016 campaign return	22%
Location	U.S.
Key individuals	Soren Aandahl Matthew Weechert

California-based Glaucus Research began publishing short ideas in 2011. Since its debut, the short seller has launched campaigns at 25 targets, of which four are now dead or delisted, according to Activist Insight data. Glaucus' many campaigns have also seen four auditor resignations and nine regulator actions, including investigations, lawsuits against the company, or the halting of a target's stock.

Most recently, Glaucus has directed its focus to Asia, specifically toward improving transparency in Japan. The short seller's July 2016 report on Japanese general trading company Itochu followed Well Investments' turn to the country and aided activists' push into the region. Yet in addition to Japan, Glaucus also continued its ongoing work in Hong Kong with the announcement of

campaigns at CT Environmental and Tech Pro Technology. The two bets brought Glaucus' total number of China and Hong Kong-based targets to 14, making Glaucus the second-most prolific activist targeting the area.

Glaucus' fourth campaign in 2016 was U.S.-based drinks company National Beverage, bringing the average market capitalization at announcement for Glaucus' campaigns in 2016 to \$6.4 billion. Remarkably, the short seller's four targeted companies all responded to Glaucus, and, on top of this, Glaucus' campaigns throughout 2016 have shown an impressive average return of 22% so far.

For its accomplishments, we name Glaucus Research the activist short seller of the year for 2016.

2 Muddy Waters Research

2016 campaigns	6
Average 2016 campaign return	-6%
Location	U.S.
Key individual	Carson Block

When it comes to activist short sellers, Muddy Waters' Carson Block is certainly one of the most well-known. Block garnered widespread attention after targeting the fraudulent \$4.5 billion Sino-Forest in the summer of 2011, with the company subsequently cratering.

Since those early days, Muddy Waters has launched a total of 26 campaigns, including six in 2016, which boast an average market capitalization at announcement of \$10.3 billion. In one of its most notable campaigns of 2016, Muddy Waters teamed up with cybersecurity

firm MedSec to allege that some St. Jude Medical home monitoring units could be exploited to cause implanted devices to malfunction and harm users. The partnership revealed to the markets a new opportunity for investors, working with hackers, to investigate whether a wide variety of sensitive products could be susceptible to attack – although it failed to prevent St. Jude's sale to Abbott Laboratories. Despite the share prices of Block's picks rising an average of 6%, his hedge fund Muddy Waters Capital reportedly returned 16% in 2016.

“Glaucus’ many campaigns have also seen four auditor resignations and nine regulator actions, including investigations, lawsuits against the company, or the halting of a target’s stock.”

3 Spotlight Research

2016 campaigns	3
Average 2016 campaign return	14%
Location	Unknown
Key individual	Anonymous

Spotlight Research is an anonymous short seller that began publishing several years ago under the name of Forensic Research Analyst. It saw success at Energous and Carbo Ceramics in 2014 and 2015, respectively, before it rebranded to Spotlight Research in April of 2016 and launched a campaign at Intrexon, calling the biotechnology company the “Theranos of public markets.” Spotlight has since seen an impressive 33% return from that name so far.

The short seller also launched a campaign at Indian film production and distribution company Eros International in June, questioning the company’s revenues and joining the ranks of other shorts at Eros, including Alpha Exposure, Glaucus Research and Asensio. Spotlight’s campaign has since seen a 16% return.

Including a third campaign at Paysafe Group, all three of Spotlight’s 2016 targets have responded to its claims, a notable mark of the short seller’s progress. Overall, the short seller boasts a 14% return for campaigns launched in 2016, as well as an attention-worthy 29% average return for all of its public campaigns to this point.

4 Citron Research

2016 campaigns	9
Average 2016 campaign return	-22%
Location	U.S.
Key individual	Andrew Left

Founded by Andrew Left, Citron Research has one of the longest published records as a short seller, stretching back to 2001. Since 2007, Activist Insight has tracked 66 campaigns from Left. And while

Citron was our Top Short Seller of 2015, the activist also had an impressive 2016.

During the year, Citron Research launched campaigns at nine different companies with a total average market capitalization at announcement of \$20.4 billion. Of those nine campaigns, Citron has already seen progress at several. In particular, its campaign at Nvidia has returned 12% since the end of December, and the activist’s campaign at Cyberdyne saw a 17% return since mid-August, when the short seller said that the robotics company was a massive stock promotion.

5 Well Investments Research

2016 campaigns	3
Average 2016 campaign return	29%
Location	Hong Kong
Key individual	Yuki Arai

Having only launched its first campaign just over a year ago, Well Investments Research has already made a huge impact in the world of activist shorts.

Its first report in December of 2015 marked the first activist short in Japan, thereby opening the door to others. Since then, Well Investments has published on three more Japanese companies, for an impressive average return of 29% for its four campaigns so far.

“All three of Spotlight’s 2016 targets have responded to its claims.”

Behind the calls

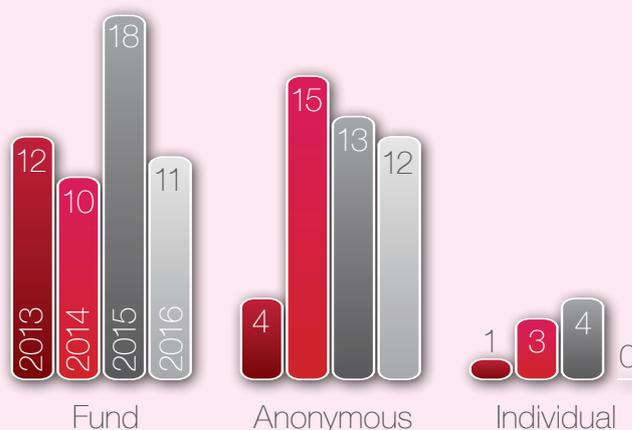
When examining shorts, we often focus on the specifics of the companies themselves, as well as the details of the allegations being made. Yet activist short campaigns come from many sources, from anonymous blog authors to well-known global funds. Claire Stovall takes a look at who's truly behind activist short calls.

Types of activist short sellers

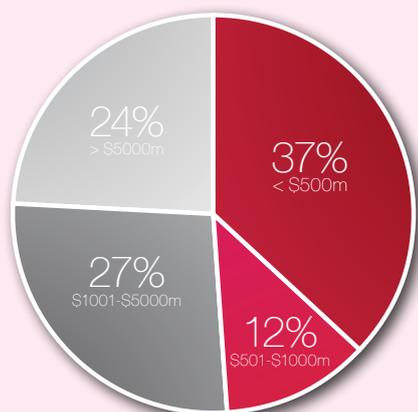
According to Activist Insight data, activist short sellers are more often than not anonymous entities and funds. Much less often, activist short sellers are classified as single individuals launching a short campaign.

2014 was a banner year for the debut of new, anonymous shorts, which have since decreased slightly. The number of new funds unveiling an activist short strategy peaked in 2015, meanwhile, at 18. With fewer new activist short sellers of all types in 2016, the balance between fund manager and anonymous was more balanced than ever.

Types of new activist short sellers by year



Breakdown of activist short sellers by fund size



Size of funds

Short calls come from funds of all sizes, where total assets under management (AUM) figures are known. Perhaps surprisingly, the average activist short seller classified as a fund has a median AUM of \$1.1 billion. But that hasn't stopped smaller funds, particularly the 15 activist short funds with less than \$500 million in known AUM. Funds in that category, including prominent short sellers like Bronte Capital and Kerrisdale Capital, have launched 70 campaigns so far since January 2013, which represents 10% of all campaigns and a remarkable 40% of campaigns launched by funds.

Location, location, location

More often than not, activist short sellers are based in the U.S., regardless of whether they are a fund, an individual or an anonymous entity. But as short sellers extend their global reach into new markets, so do the locations of the activists themselves. This year saw the debuts of short sellers located in Singapore, Canada, Hong Kong and the U.K.. Notably, the count of known U.K. activist short sellers doubled from two to four in 2016, and we saw the first known activist short seller based in Singapore. 🌐

Activist short sellers by location of head office



1 each: Australia, China, Denmark, Israel, Singapore, Switzerland, U.A.E., Virgin Islands



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Down and up

For activists, 2016 was a disjointed year, with mixed fortunes either side of the summer. Nonetheless, a late rally puts a shine on activist strategies yet again, writes Josh Black.

Activists began 2016 with investors apparently universally unhappy at their performance. Stocks prominent among value investors and hedge funds alike were among the worst hit by an upswing in volatility, commodity price swings came unpredicted, and the growing intensity of the battle between proponents of active and passive investment strategies seemed to put activism on the wrong side of the debate.

Back in the race

Fast forward to the end of 2016, and the situation is practically reversed. The Activist Insight Index had returned 8.6% net of fees by the end of the third

quarter – the latest period for which full results were available – beating the S&P 500 Index by 75 basis points and the MSCI Index by 255 basis points.

The Activist Insight Index, which is made up of “primary focus” funds that identify activism as their main strategy, has been on a three-year losing streak against the S&P 500 Index, last besting that benchmark in 2012. On a cumulative basis since it was first calculated in 2009, it now leads the S&P 500 Index again, having ceded the advantage a year previously.

That may yet change as full-year data is added. However, the argument that activists were more closely correlated to

the market than they like to admit – one originally advanced by critics of activism – now seems to benefit activists again. Algorithmic “smart beta” – which aimed to pick stocks with basic correlation to the market but a slight edge – may mostly have performed abysmally. The more manual kind, pressuring companies to create value through operational enhancements, better capital allocation and through transfers of ownership, has fared better.

Performance distribution

According to Activist Insight Online’s stock-tracking feature, Follower Returns, the average annualized return from an activist-owned stock was 14.6%

Compounded Activist Insight Index versus S&P 500 and MSCI World indices since 2009



“With markets continuing to rise following November’s presidential election, value may be more difficult to find.”

in 2016 – almost five percentage points ahead of the S&P 500 Index, which had a return of just under 10%. Primary and partial focus activists did slightly worse, returning an average annualized 13.2%. Nearly two-thirds of annualized activist-targeted Follower Returns finished higher by the year-end, and 51% beat the S&P 500 Index.

The data now include select foreign exchanges, where investments in the likes of Rolls-Royce Holdings continued to perform well, thanks to devaluations against the dollar caused by events such as the British referendum on EU membership in June and the U.S. presidential election in November. Yet, despite favoring exporters and sometimes delivering paper profits, devaluations can mean a real currency-adjusted loss for foreign investors – something ValueAct

Capital Partners will be conscious of as it measures the progress of the engine-maker’s turnaround.

Where actual performance numbers are unavailable, tracking activist stock picks can give a handy insight into which funds are best adapting to conditions. Teleios Capital Management gained from Brexit, while JCP Investment Management – the small cap fund run by the restaurant family scion James Pappas – enjoyed success across eight of its nine activist investments. Although its outcomes were more widely distributed, the signs also point to a good year for Marcato Capital Management.

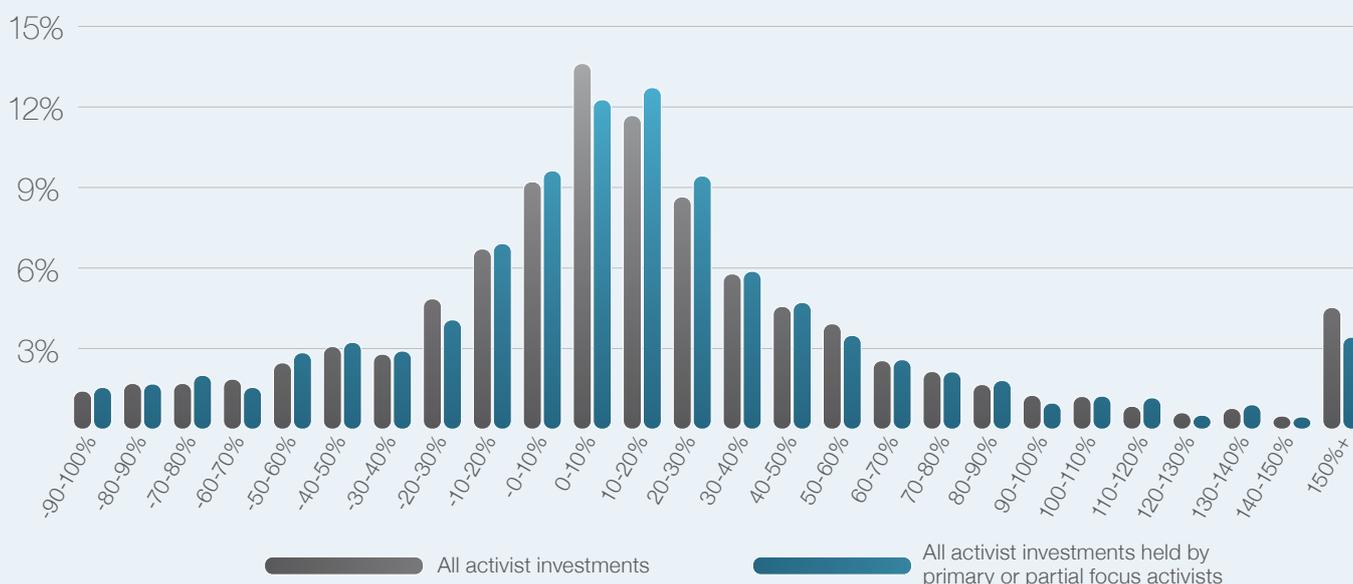
The outlook

With 2017 and several potential market-moving events looming large – including a possible U.S. corporate tax holiday,

greater clarity on the U.K.’s plans for negotiating its exit from the EU, and rising interest rates – activists will be mulling a series of difficult decisions. Last year’s attempt to push consolidation in certain sectors backfired, with antitrust regulations coming between the likes of Office Depot-Staples and Baker Hughes-Halliburton and a payoff for their investors. This year may see more attention to offshore pharmaceuticals companies.

With markets continuing to rise following November’s presidential election, value may be more difficult to find. That may mean activists either continue to tone down their demands, or concentrate on event-driven and balance sheet demands that deliver a quick win for shareholders. Activism is no longer out in the cold, but may have some way to go to be hot again. [↴](#)

Annualized Follower Returns (%) of activist investments in 2016



Who's vulnerable now?

January 2017 saw the launch of *Activist Insight Vulnerability*, a new predictive tool for identifying probable targets of activist investors. Here, we demonstrate a number of uses for the data it provides, including six companies that might attract an activist this year.

While activists are known for using a variety of methods in selecting investments – including RFAs (or “requests for activist”) and M&A gossip, back-testing Activist Insight’s database of campaigns suggests that a few factors have greater predictive power than others. As a result, *Activist Insight Vulnerability* assigns issuers a vulnerability score based on four metrics: one-year total shareholder return relative to peers, one-year return on average equity relative to peers, institutional ownership and pre-existing activist ownership – the latter, in particular, suggesting that activist “wolf packs” are more than a fable.

At the start of 2017, 51% of S&P 500 companies were ranked as highly vulnerable to an activist campaign in the next nine months, compared to a pre-set level of one-third for the wider dataset of U.S. issuers. That is undoubtedly in part a consequence of the heavy institutional ownership of the index – despite protestations from index funds that they are less keen on short-term changes brought about by activist pressure.

A handful of measures suggest that it may be worth continuing to watch the technology sector in 2017. Disparate total shareholder returns made for a higher number of underperformers than in other sectors, while 30% of companies saw greater than 10% opposition to at least one director and 70% trade below the sector’s average price-to-earnings ratio.

Those indicators notwithstanding, Activist Insight has picked six stocks to watch.

Ones to watch

AutoNation

Ticker	AN
Sector	Services
Industry	Auto Dealerships
Market cap	\$4.9b (Dec 30, 2016)

Currently, AutoNation trades at just over 13-times earnings, while rivals CarMax and Group 1 Automotive trade at over 21-times earnings, and, despite a recent rally, has underperformed peers over the past 36 months. Operational and strategic changes may need a push, and AutoNation’s share register looks ready-made for a confrontation. Dedicated and occasional activists such as Glenview Capital Management, Gamco Investors, Wexford Capital, Eminence Capital and Artisan Partners were all invested in the company as of September 30, while Eddie Lampert’s ESL Investments and Bill Gates’ family office Cascade Investment own more than one-third of the stock between them. A dissident investor would not need to search long to find shareholders ready to listen, and it would not come as a surprise if an activist were already pushing for changes behind the scenes.

Mead Johnson Nutrition

Ticker	MJN
Sector	Consumer Goods
Industry	Processed & Packaged Goods
Market cap	\$13.1b

In an industry that has become a popular target for activists, Mead Johnson Nutrition has so far managed to stay off investors’ radars. However, that may change, as shares have fallen nearly 30% over the last two years. And while 2016 was relatively flat, its peer group returned 6.8% on average, while revenues for Mead Johnson fell below \$4 billion for the time since 2012. As a result, an incoming activist could demand the company reach into its growing pile of excess cash – now at \$1.8 billion – and buyback shares or implement cost-cutting initiatives, such as getting rid of its struggling Latin America division. The latter approach would improve upon its negative 87% return on average equity, a long way from its peer group’s return of 20.6% in the last 12 months.

A handful of measures suggest that it may be worth continuing to watch the technology sector in 2017.

Dentsply Sirona

Ticker	XRAY
Sector	Healthcare
Industry	Medical Instruments
Market cap	\$13.3b

With the likes of Baxter International, Hologic and Harris falling prey to activists in the past, Dentsply Sirona will hope to make 2017 the year of deal integration. Shares in dental equipment maker Dentsply Sirona traded down 6.5% from the completion of its merger on February 29, 2016 at a time when medical companies enjoyed a bullish year. Concerns about board independence led to a 14% vote against nominating committee member Michael Alfano and return on average equity sits at roughly half its peer group.

Noble Energy

Ticker	NBL
Sector	Basic Materials
Industry	Agricultural Chemicals
Market cap	\$16.4b

With 96% of its stock held by institutional investors, Noble Energy's board can expect to be held to account, as at the 2016 annual meeting, when more than one-third of votes were cast against the election of director James Craddock, who was not considered independent enough to serve on the governance and nominating committee. With Noble severely underperforming its peers in terms of total shareholder return, net margins, earnings growth and many other indicators, an activist may easily be tempted to start demanding for changes, especially if the recent acquisition of Clayton Williams Energy fails to work out.



Activist Insight Vulnerability

Please email info@activistinsight.com for further information.

HCP

Ticker	HCP
Sector	Financial
Industry	REIT – Healthcare
Market cap	\$15.4b

Shares in healthcare real estate investment trust HCP were down 15% in 2016 and a deal between rival Brookfield Senior Living and private equity giant Blackstone puts additional pressure on the company at a time when real estate values are soaring and activists have been looking on keenly. Cost-cutting or M&A activity are common demands in the sector, especially as HCP's earnings are stalling even as dividends rise. Despite uncertainty with healthcare reform, the REIT looks cheap.

CF Industries

Ticker	CF
Sector	Basic Materials
Industry	Agricultural Chem.
Market cap	\$7.3b

After spending over \$1 billion in 2015 to acquire English counterpart GrowHow UK from Yara International, Illinois-based CF Industries built up its cash reserves last November through a senior note offering that has pushed its excess cash to over \$1.5 billion. Activists could lean on CF Industries to repurchase shares, as it already offers a healthy dividend. Implementing cost-cutting initiatives presents an alternate route, as the chemical producer lags behind its peers in both gross and net profit margins. Its cost of goods sold has also increased from a year prior, and while its heavy institutional ownership bodes well for an activist, a potential investor would have to contend with a poison pill.

Rote reliance out of fashion

Attempts at reforming proxy voting advisers exposed divergent beliefs about their impact on shareholder voting. Nick Dawson, managing director of Proxy Insight, reveals that shareholders rely less heavily on these agencies than is commonly thought.

As the scope and quantity of shareholder voting has increased, the perception that institutional investors rely disproportionately on proxy voting advisers has become increasingly common. More than three years ago, Daniel Gallagher, then a commissioner of the Securities and Exchange Commission, gave a speech urging investors “to take responsibility for their voting decisions rather than engaging in rote reliance on proxy advisory firm recommendations.”

The speech, and Gallagher’s suggestion of an obligatory code of conduct that would make them

responsible for increasing shareholder value, kick-started the process that led to a 2016 bill – the Corporate Governance Reform and Transparency Act of 2016 – aimed at enhancing SEC control of proxy advisers by requiring their registration and annual reporting on the quality, competitiveness and transparency of the market. The bill lost momentum before November’s election, but critics of proxy voting advisers will likely continue to make their case into 2017.

In fact, shareholders are less dependent on proxy voting advisers than is commonly assumed. Few say on pay votes fail, even when

proxy advisers recommend their clients withhold their support, and recent years have seen conspicuous examples of proxy contests whose outcomes have not mirrored proxy adviser recommendations.

Proxy Insight’s contribution to the debate adds to the case for the defense. Using voting data for the ten largest institutional investors, Glass Lewis’ recommendations and assumptions based on voting behavior about Institutional Shareholder Services’ (ISS) recommendations (which we describe as synthetic recommendations for short), Proxy Insight is able to illustrate that the correlation between proxy advisory recommendations and shareholder voting is less powerful than critics allege.

In U.S. and U.K. say on pay votes for the past two years, the largest investors showed little instinct for blindly following the suggestions of proxy advisers. While investor votes correlated with ISS 90-91% of the time and Glass Lewis 83-84% of the time when all votes were included in the analysis, the picture was strikingly different for contentious votes, where either adviser recommended voting against management.

A little over half – 54% of investors in 2015 and 51% in 2016 – voted the same way when ISS recommended against management. For Glass Lewis, the correlation was even weaker, with just 34% of investor votes in 2015 and 30% in 2016 going the same way as

Correlation between top investor votes and PVA recommendations on US/UK SoP resolutions

	All recommendations	
	ISS	Glass Lewis
2016	90.3%	83.2%
2015	90.5%	84.4%

Correlation between top investor votes and PVA recommendations “against” US/UK SoP resolutions

	Against recommendations	
	ISS	Glass Lewis
2016	51.4%	29.5%
2015	53.8%	33.6%

“Either proxy advisers are becoming tougher on pay in a way investors are unwilling to support, or institutions are easing up on executive pay.”

“Shareholders are less dependent on proxy voting advisers than is commonly assumed.”

the adviser’s recommendation. Since 2015, the top investors only voted against management in 61.8% of say on pay resolutions where both ISS and Glass Lewis recommended against.

Either proxy advisers are becoming tougher on pay in a way investors are unwilling to support, or institutions are easing up on executive pay. Looking at investors individually gives a good indication of how independent large institutions actually are. BlackRock diverged from ISS’ “against” recommendations 76% of the time in the U.S. over 2015 and 2016 – higher than Vanguard at 62%.

Some correlation may be explained by the size and scope of investors’ governance teams. BNY Mellon voted the same way as ISS in 100% of U.K. say on pay votes, but only 81% of the time in the U.S., suggesting a greater willingness to override recommendations. For four of the top ten investors, voting was more aggressive relative to ISS recommendations in the U.K. than in the U.S., suggesting different cultures or standards might play a role. With Glass Lewis, the ten largest investors were evenly split on whether they were more or less aggressive than the adviser. Only two, however, were more than 50% correlated with its recommendations against management.

Proxy advisers will likely jump on these figures as evidence that their influence over their clients is less strong than

has been portrayed. In submissions to the House of Representatives’ financial services committee on publication of the bill, both firms noted that clients retained their own policies, and moreover, pointed out that proxy voting adviser recommendations were themselves partly based on investor preferences.

Yet, notably few of the institutions showed much interest in opposing executive pay when proxy advisers recommended they offer their support – with one notable exception. BNY Mellon proved more aggressive than the advisers on over 1,200 compensation votes – more than one-third of situations in which recommendations were for management, showing that some assumptions are made to be overturned.

Correlation between top investor voting and ISS recommendations on US/UK SoP resolutions

	Against recommendations		
	All	US	UK
BlackRock	25.3%	24.2%	35.2%
Dimensional Fund Advisors	100.0%	100.0%	100.0%
Vanguard Group	35.0%	37.8%	11.5%
State Street	44.6%	46.3%	30.0%
Fidelity Management & Research	34.6%	34.9%	32.1%
BNY Mellon	83.0%	81.4%	100.0%
Goldman Sachs Asset Management	40.7%	28.6%	97.2%
Northern Trust	12.7%	13.7%	0.0%
T. Rowe Price	56.5%	55.3%	69.0%
Alliance Bernstein	93.1%	92.6%	97.7%

A close-up photograph of a hand holding several red dice. The hand is positioned as if about to drop them. The background is dark and out of focus.

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