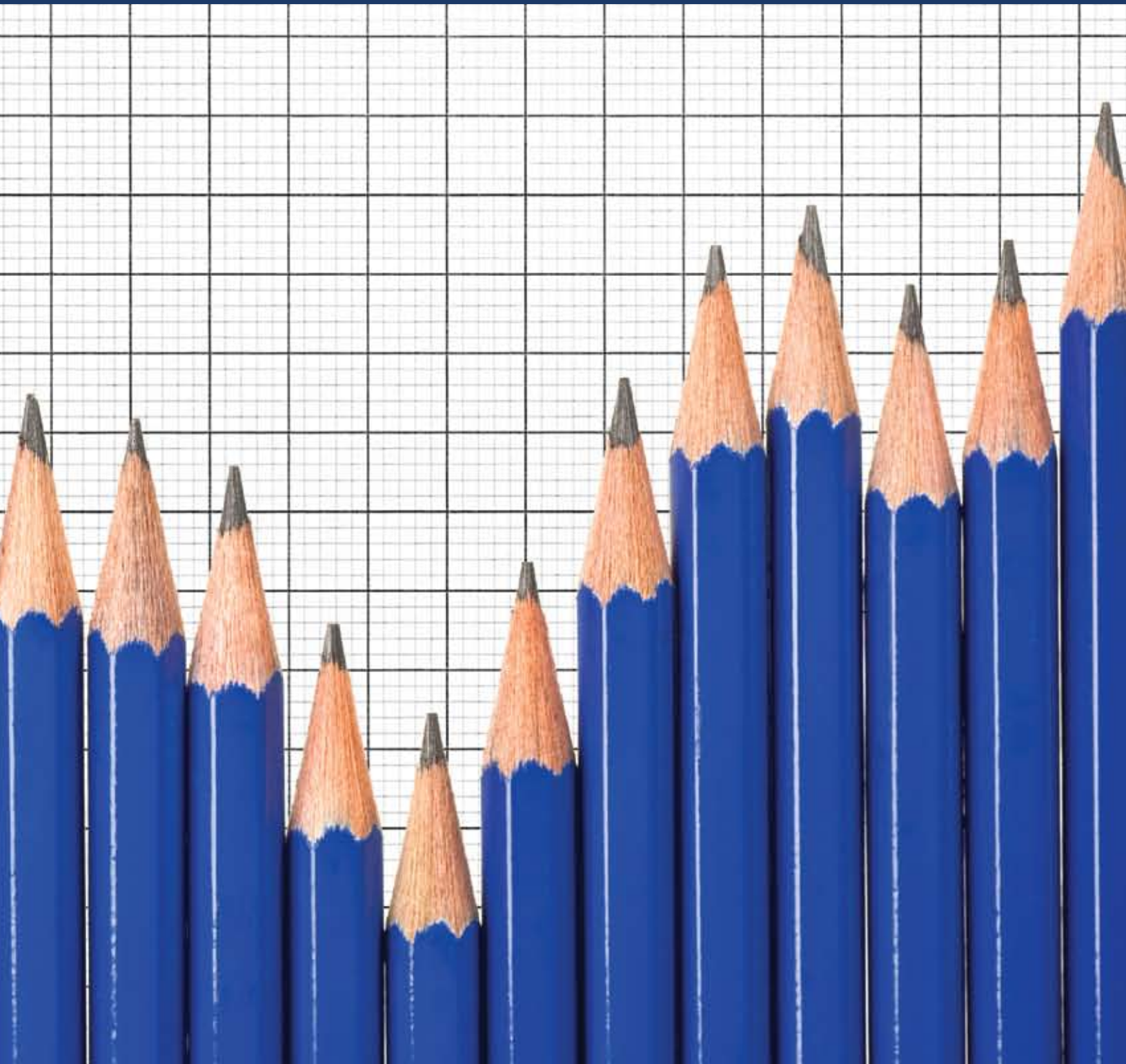


Shareholder Activism Insight

A Schulte Roth & Zabel LLP report in association with mergermarket



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Foreword

Schulte Roth & Zabel is pleased to present the second edition of Shareholder Activism Insight, published in association with mergermarket. Based on a series of interviews with corporate executives and activist investors, this report highlights emerging trends in shareholder activism and examines the new challenges facing investors and executives in the current market.

The majority of both corporate (60%) and activist (64%) respondents expect shareholder activism to increase over the next 12 months. This represents a notable shift in corporate respondents' sentiment since the first edition of this study was published in 2008, when only 39% of corporate respondents said they expected shareholder activism to increase in 2009 and 2010.

While respondents generally agree that shareholder activism is on the rise, corporate and activist respondents are divided as to the specific drivers behind this increase. The majority of activist respondents say excessive cash on companies' balance sheets (68%) will play the most important role in fueling activism in the upcoming 12 months, but the majority of corporate respondents (54%) believe financial performance will be the most significant trigger. Respondents do tend to agree, however, that new 'say on pay' rules will play an important role in fueling shareholder activism in the year ahead, more so than any other financial reforms.

Not surprisingly, the majority of both corporate and activist respondents expect to see increased activism on the part of hedge funds over the next 12 months. But their outlook for other investors is mixed: when asked which investors are likely to become increasingly active in the coming months, the majority of activist respondents (68%), but only 38% of corporate respondents, identify pension funds.

Respondents are also divided on the issue of shareholder involvement in M&A: the large majority of activist respondents (76%) believe shareholders will become more active in connection with companies' proposed M&A strategies, compared to just 40% of corporate respondents.

Differences notwithstanding, respondents on both sides emphasize the importance of communication: the majority of activists view communication as their most effective strategy in achieving desired results, and the majority of corporate respondents likewise view communication as the best defensive strategy in dealing with activist investors. Other tactics appear to have fallen out of favor over the past 12 to 24 months: in the first edition of this report, one-quarter of corporate respondents believed staggered board elections were the best defensive strategy, but now a much smaller proportion of respondents agree.

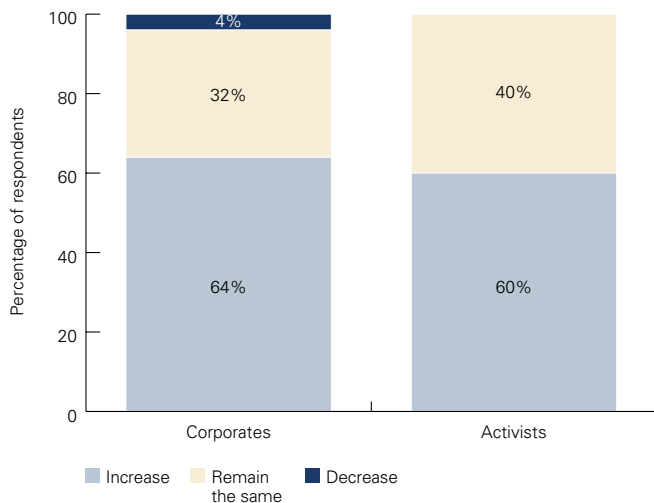
In addition to the above findings, this report provides insight into a variety of issues including proxy access, the role of proxy advisory firms, and board representation. We hope you find this study both informative and useful and as always, we welcome your feedback.

Methodology

In the third quarter of 2010, Schulte Roth & Zabel commissioned mergermarket to interview 25 senior corporate executives and 25 activist investors regarding their experience with shareholder activism and their expectations for the upcoming 12 months. All respondents are anonymous and results are presented in aggregate.

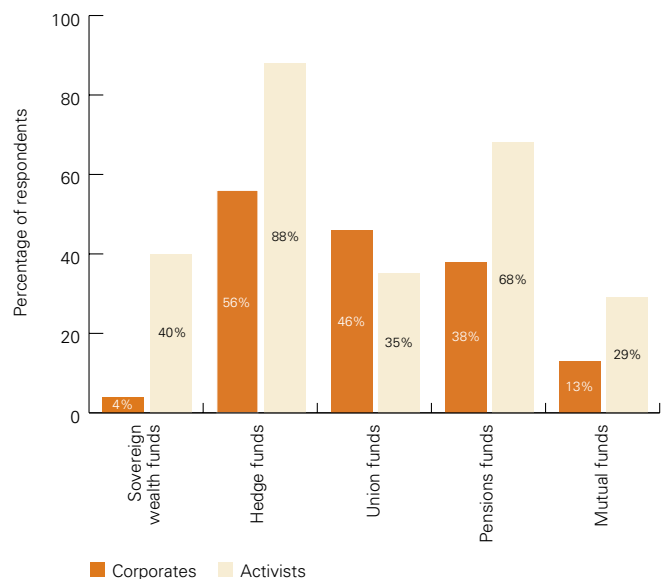
Study findings

What do you expect to happen to the volume of shareholder activism over the next 12 months?



- In terms of overall volume, the majority of both corporate and activist respondents predict an increase in shareholder activism over the next 12 months. Other respondents generally expect activity to remain at its current level. This represents a significant change from the first edition of this report, published in 2008, where although the overall majority of respondents predicted (both then and now) an increase in shareholder activism, only 39% of corporate respondents expected a significant increase in 2008 as compared to 64% of corporate respondents expecting a significant increase in 2010-2011.
- Shareholder activism has received considerable media attention since the first edition of this survey, due largely to high profile activist involvement in company restructuring and M&A strategies in recent years. Activism is set for a continued rise, with recently-passed regulations allowing shareholders more sway and increased participation from retail investors.

From which of the following investor groups do you expect to see increased activism over the next 12 months?



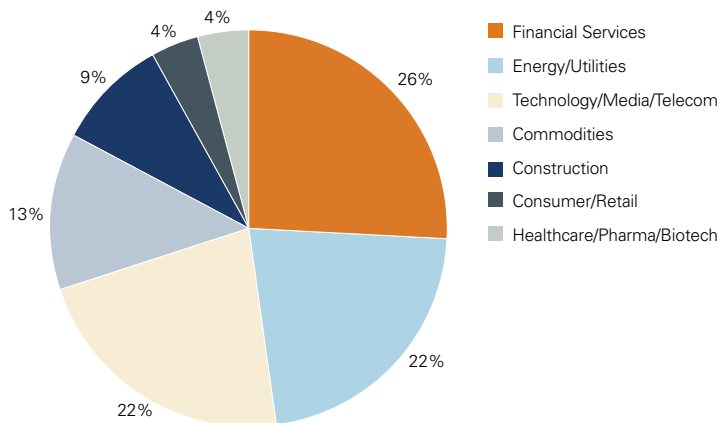
- The majority of both corporate and activist respondents expect hedge fund investors to increase their activism over the next 12 months, but respondents' outlook for other investor groups is largely divided. In addition to hedge funds, the majority of activist respondents (68%) also expect to see increased activism on the part of pension funds, but only 38% of corporate respondents agree. In fact, activists have a markedly more bullish outlook than corporate respondents when it comes to all investor groups, barring union funds, from which 46% of corporate respondents and 35% of activist respondents expect increased activism.

"Activists should have a good sense of the various investor groups likely to increase their activist activity, and if they're right then corporate executives are in for a surprise as the source of increased investor activism — investor groups that formerly were reluctant to utilize activists tools are losing that reluctance."

Marc Weingarten, Partner, Schulte Roth & Zabel

Activists

In which sector do you expect to see the most shareholder activism over the next 12 months?



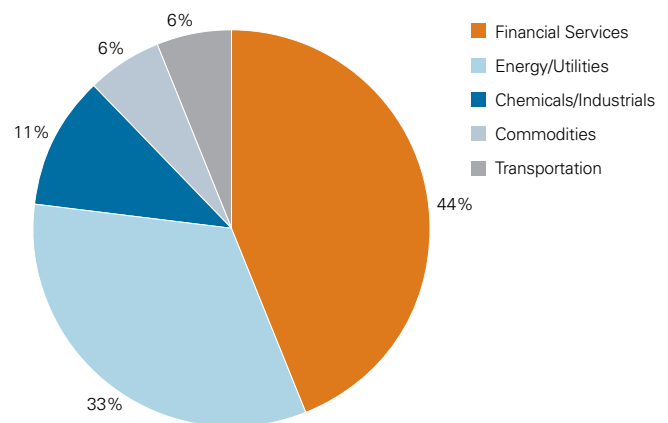
- Respondents are generally divided on the issue of sector-specific activity. While corporate respondents expect the most activism to occur in the financial services sector (44%) and the energy sector (33%), activist respondents are divided across a range of industries including financial services (26%), energy and utilities (22%) technology, media and telecom (22%) and commodities (13%).

“Activists expect to see a reasonable amount of activism in the Technology/Media/Telecom sector, while corporate respondents did not predict that at all. This sector may be in for an unpleasant surprise.”

Marc Weingarten, Partner, Schulte Roth & Zabel

Corporates

In which sector do you expect to see the most shareholder activism over the next 12 months?



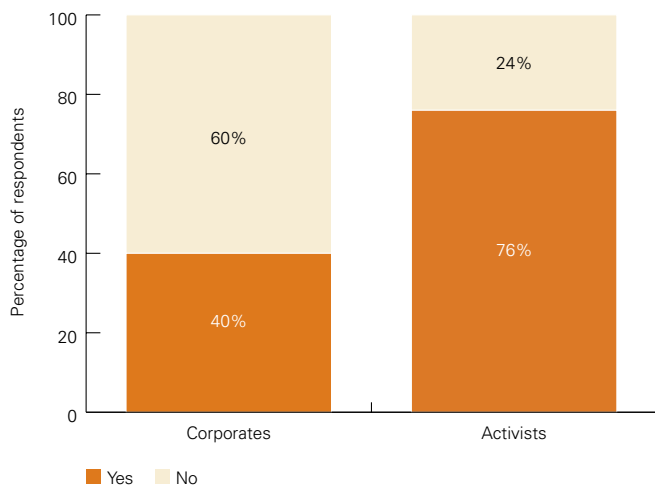
- Respondents from both groups elaborated on this issue, pointing to continued restructuring in the financial services sector, combined with lingering negative sentiment from the financial crisis, as potential drivers of shareholder activism. Interestingly, several respondents from the corporate side comment that shareholders in all industries will become more heavily involved in distressed companies' restructuring plans, including debt restructuring and asset sale strategies.

“Corporate executives seem to have a much greater impression that activism is sector specific, when in reality it typically is focused on a perceived failure to optimize at a company specific level.”

David Rosewater, Partner, Schulte Roth & Zabel

Study findings

Do you expect shareholders to be more active in connection with companies' proposed M&A transactions over the next 12 months than they have been recently?

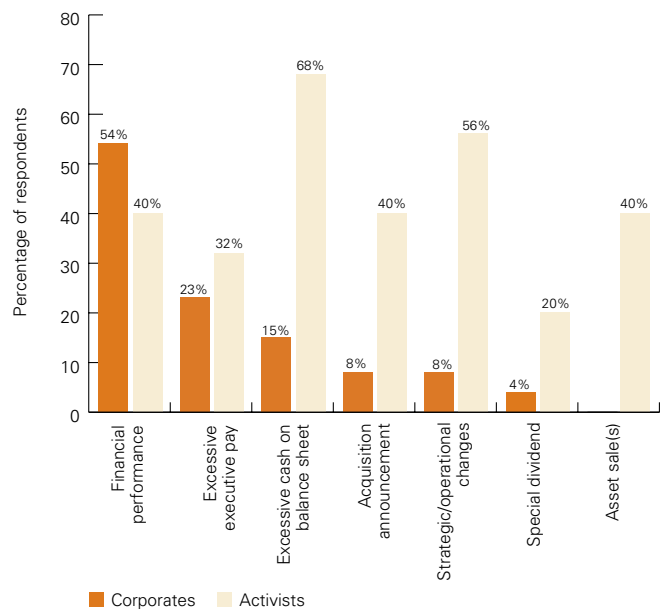


- Since the first edition of this survey was conducted in 2008, shareholders have proved to be quite vocal and effective in influencing companies' M&A strategies. More than three-quarters of activist respondents expect shareholders to become increasingly involved in companies' M&A strategies going forward, but only 40% of corporate respondents agree that this will be the case in the next 12 month period. This does not necessarily mean that corporate respondents expect shareholders to be passive when it comes to M&A, however, as one corporate respondent explains: "There has already been a lot of shareholder involvement, and it will probably stay this way. A lot of investors are speaking out on valuations."

"Activists expect to be increasingly involved in influencing companies' M&A strategies. With the increasing level of strategic M&A and private equity activity, this no doubt means more 'hold-up' campaigns, where activists oppose proposed transactions, or at least their pricing."

Marc Weingarten, Partner, Schulte Roth & Zabel

Which catalysts will most likely cause shareholders to go active over the next 12 months?



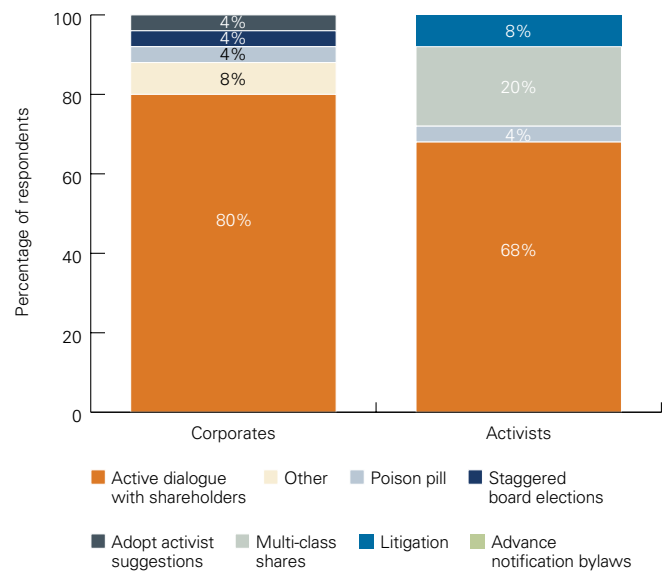
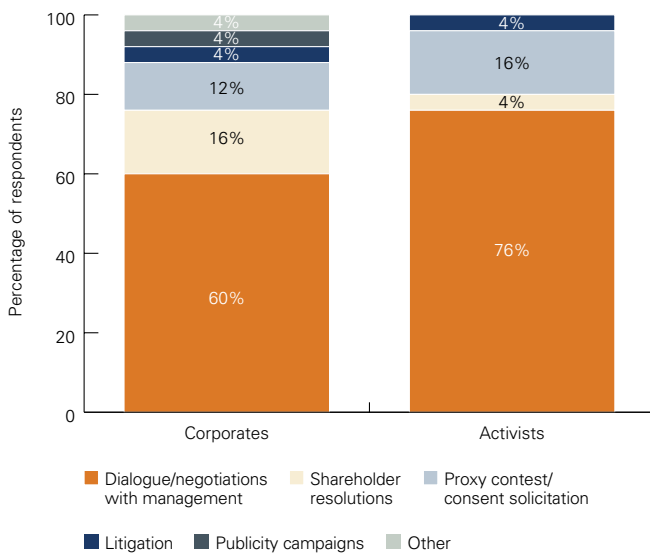
- Again, there is a sharp division among respondents on the issue of specific catalysts to shareholder activism. Interestingly, more than half of corporate respondents (54%) believe financial performance will be the most significant trigger for shareholder activism in the months ahead, followed by executive compensation schemes, but activist respondents believe otherwise. The majority of these respondents instead cite excessive cash on companies' balance sheets (68%) and strategic or operational changes (56%) as the top two causes.
- Activist respondents' bullish outlook in this area is reflected in much of their commentary, with several of these respondents pointing out that valuations will be a contentious issue for shareholders looking at potential M&A transactions. Additionally, some activist respondents predict that excessive cash on a company's balance sheet will trigger activism if investors believe companies are not taking advantage of growth opportunities.

"In the aftermath of the economic crash, activists would have found little support in seeking to cause companies to part with their cash nest eggs, especially to buy back stock at depressed prices. As the economy rebounds and the market continues to rise, this attack will likely be back in favor."

Marc Weingarten, Partner, Schulte Roth & Zabel

Which activist strategy is most effective for achieving desired results?

What is the most effective defensive tactic a company can use against activist shareholders?



- As was the case in the first edition of this report, the majority of both activist and corporate respondents believe communication is the most effective activist strategy. An activist respondent explains: "Open communication is critical, and it is less contentious than the other options. It is our experience that fruitful dialogue works best when you're trying to reach a settlement."
- Corporate respondents are more divided than activist respondents when it comes to specific strategies: apart from the 60% majority, remaining corporate respondents believe activists can be most effective by using shareholder resolutions or proxy contests.

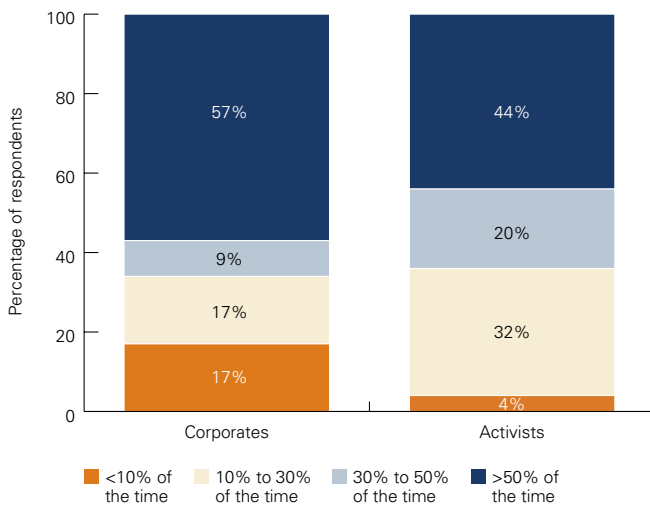
- Communication is critical on the corporate side as well. The large majority of both corporate and activist respondents agree that dialogue is a company's best defense mechanism against activist shareholders. An additional one-fifth of activist respondents believe multi-class shares are companies' best defense. Other tactics appear to have fallen out of favor in recent years: in the first edition of this report, one-quarter of corporate respondents believed staggered board elections were the best defensive strategy, but now only a small minority agree.
- Respondents are particularly vocal on this issue. A corporate respondent explains: "The key is transparency, and to have open arms. Ignoring shareholders will just stoke the fires." Another corporate respondent further explains that dialogue "is the best way to avoid public damage to the company."

"Compared to two years ago, activists seem in a mood to compromise. The percentage of activists citing active dialogue as an effective strategy has more than doubled."

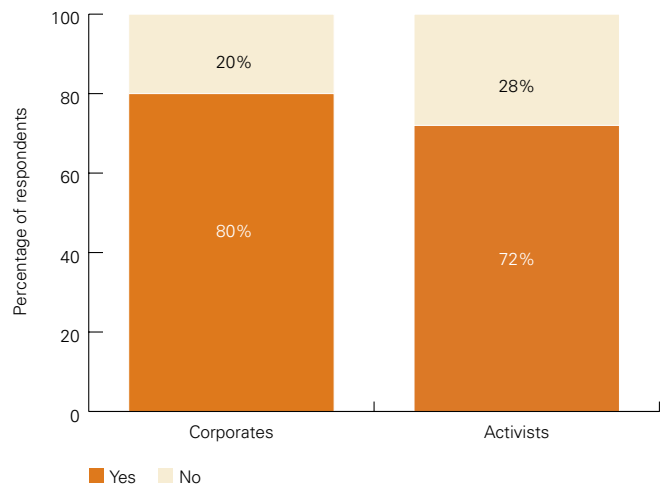
David Rosewater, Partner, Schulte Roth & Zabel

Study findings

In your experience, how often do activist investors and corporations work together cooperatively without receiving media attention?



Do you expect shareholders to take advantage of proxy access over the next 12 to 24 months?



- While large shareholder disputes tend to dominate the headlines, most respondents believe companies and shareholders often cooperate outside of the media glare. The outlook has become more positive since the first edition of this report, in which only one-third of corporates and one-quarter of shareholders believed cooperation was typical more than half of the time.
- Several respondents discuss this issue in more detail. Many corporate respondents point out, for example, that it depends on shareholders' specific demands: "This usually depends on what they are asking for. If there is a ten-seat board and shareholders are asking for five seats, that is not going to work. But if they have a specific suggestion, such as changes in compensation, that might be taken into consideration."
- The large majority of respondents believe shareholders will take advantage of proxy access over the next 12 to 24 months. New proxy access rules will make it significantly easier for activist investors to engage in companies' activities, say many respondents from both sides, and will definitely encourage shareholder activism in the upcoming years. An activist respondent comments: "In my opinion, proxy is still weak in itself. But with changing proxy rules the shareholders may be able to utilize them better."

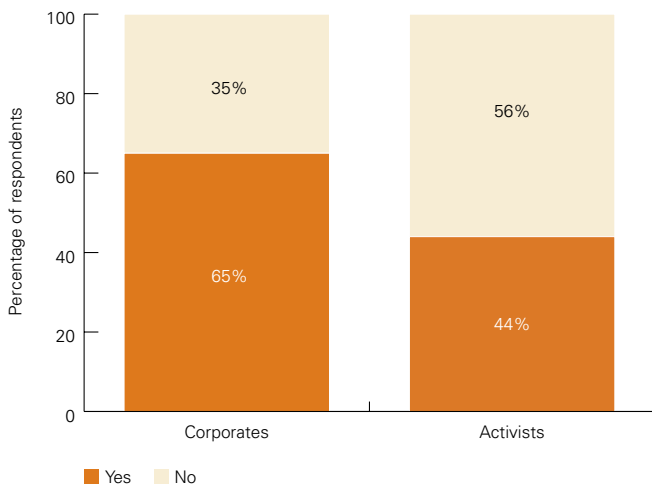
"In our experience, settlements achieved without a fight are much more common than public disputes or proxy fights."

David Rosewater, Partner, Schulte Roth & Zabel

"Proxy access is once again in limbo. We suspect that if it comes back into effect, it will be utilized more by social-issue investors, like unions, or by investors promoting best practices in corporate governance, like pension plans and institutional investors, rather than by financial activists."

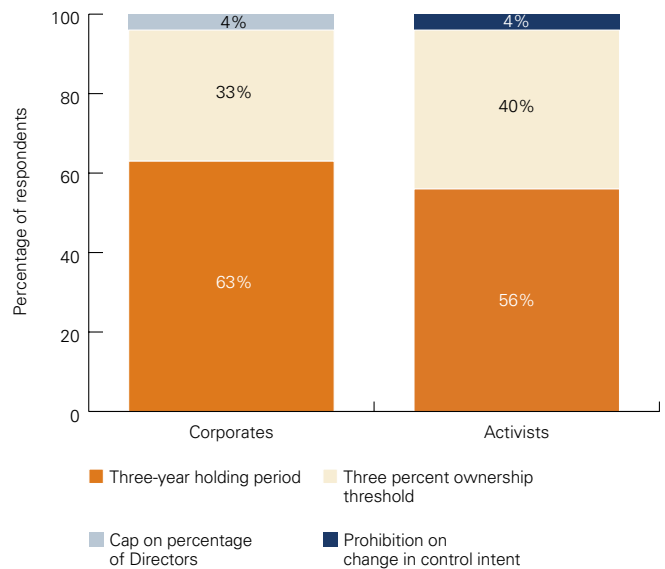
Marc Weingarten, Partner, Schulte Roth & Zabel

If yes, do you expect this to be a long-term trend?



- Most respondents expect shareholders to take advantage of proxy access over the next 12 to 24 months, but whether this will continue is debatable. A significant 65% of corporate respondents believe shareholders’ use of proxy access will be a long-term trend, but more than half of activist respondents believe otherwise.

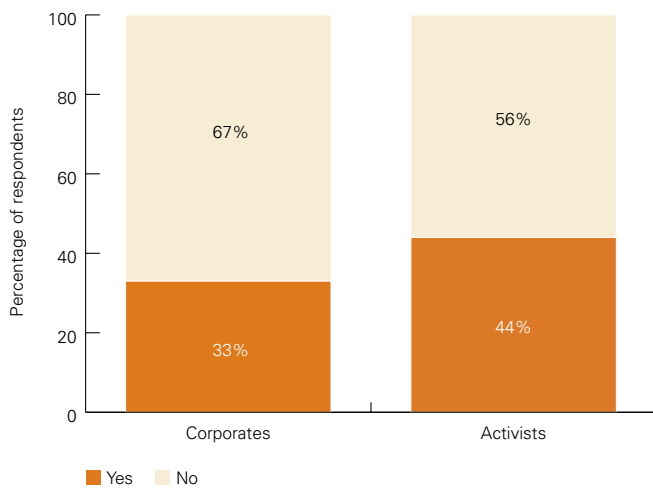
Which aspect of the conditions to proxy access is the most significant impediment to activist investors utilizing the access right?



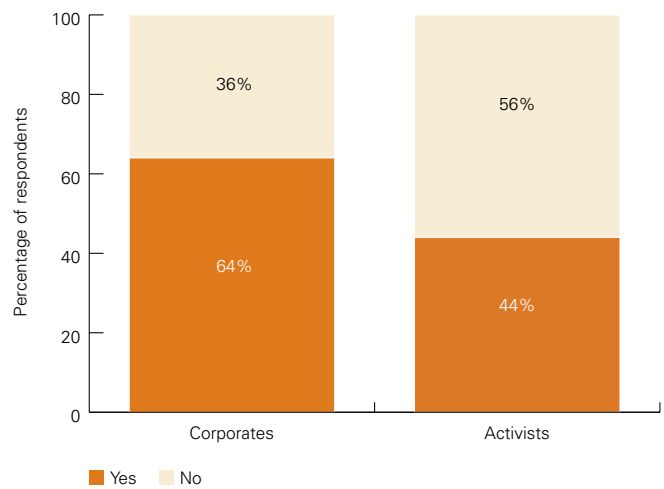
- Corporate and activist respondents are generally in agreement that the three-year holding period restriction will be the greatest impediment to activists’ exercising their proxy access right, but much of corporate respondents’ commentary suggests that this will not be a bad thing. One respondent explains: “Anyone holding for more than three years has been engaged in active dialogue and knows the company, whereas short-term investors are just looking for gains.” This finding is particularly interesting given that many activist respondents hold onto investments for one year or less.

Study findings

Do you expect increased participation of retail investors, through new voting avenues (e.g. MoxyVote.com, ProxyDemocracy.org), to be a long-term trend?

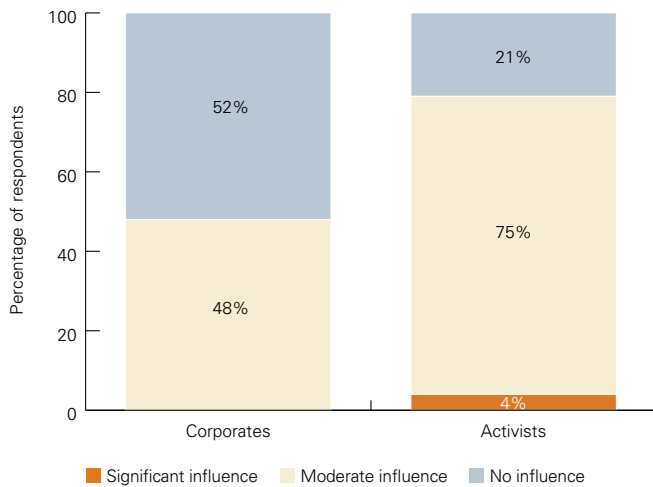


Will you solicit the opinion of a proxy advisory firm over the next 12 months?

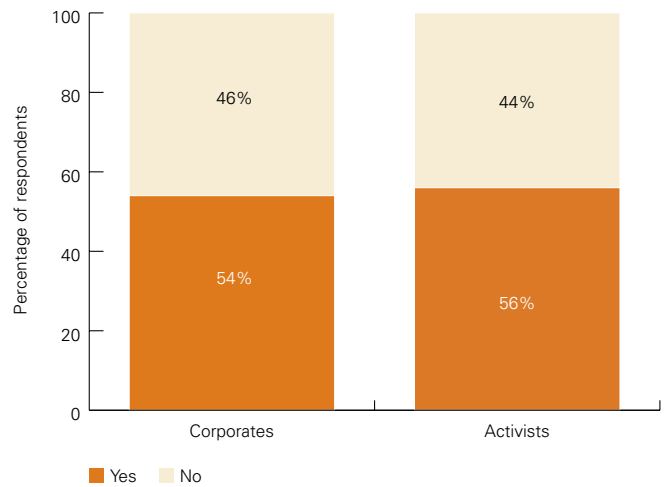


- Respondents are skeptical as to whether retail investors will continue to be actively involved in voting through non-traditional, online voting avenues. These outlets have already encouraged investor participation in recent years by making the voting process easier and more accessible to a broader audience of investors, but this trend may not carry over into improved market conditions, as corporate and activist respondents both point out that the financial crisis has made investors, like the general public, more wary of corporate decision making. Investors may become less sensitive to these issues when the market stabilizes.
- While the majority of activists will not use proxy advisory firms in the next 12 months, these respondents nevertheless believe proxy advisors will play a role in increasing shareholder activism during this time. Shedding light on these figures, activist respondents comment that proxy advisors are best suited to investors who are not usually active or familiar with proxy materials: "Some shareholders are not able to figure the flaws in proxy materials and this could be rectified through the expertise of an advisory firm."

How strong an influence will proxy advisory firms have on increasing shareholder activism over the next 12 months?



Do you expect the Dodd-Frank Act to make companies more responsive to shareholders over the next 12 months?



“The SEC has taken notice of the influence of proxy advisory firms, devoting an entire section of their recent Concept Release on the U.S. Proxy System to questions exploring the potential limitations on that influence and conflicts of interest that may exist at these firms that would color how that advice is directed.”

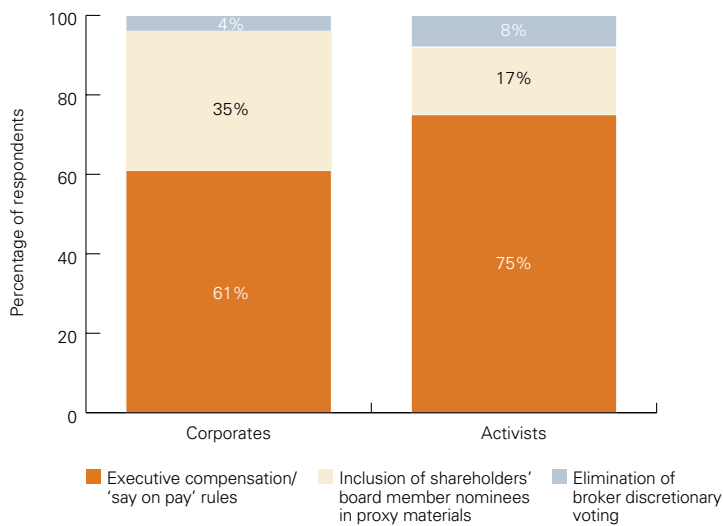
David Rosewater, Partner, Schulte Roth & Zabel

- Respondents are generally divided as to whether the Dodd-Frank Act will make companies more responsive to shareholders, with just more than half of each respondent group expecting this to be the case over the next 12 months. Comments from both corporate and activist respondents shed light on this division: respondents from both camps point out that increased visibility and awareness of corporate decision-making and its impact on shareholders will have more to do with shareholder responsiveness than financial reform itself.

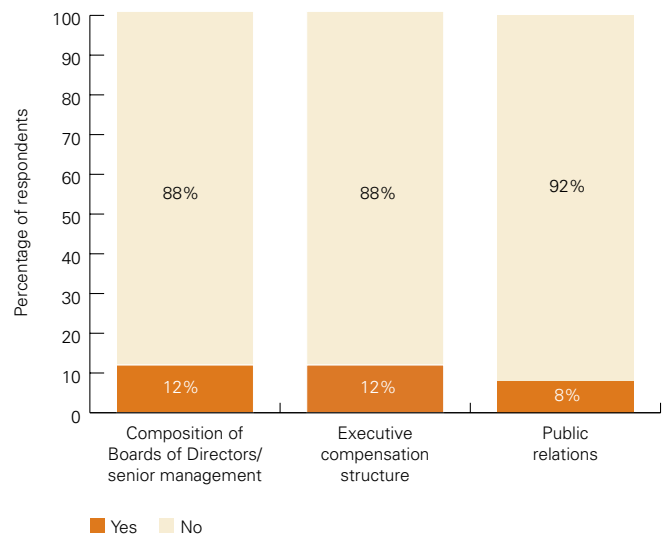
Study findings

Corporates only

Which of the following rules/regulations will have the greatest impact on the volume of shareholder activism over the next 12 months?



In light of the Dodd-Frank Act, do you plan to change your approach to the following areas?

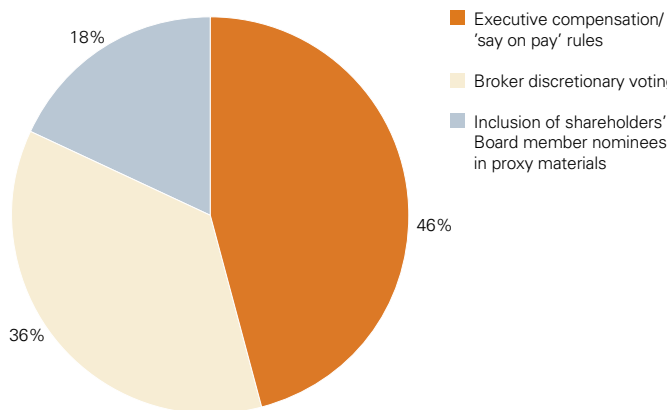


- The majority of both corporate and activist respondents believe 'say on pay' rules will have the greatest impact on shareholder activism in the next 12 months. Meanwhile, one-third of corporate respondents – compared to less than one-fifth of activist respondents – say the same of regulations related to the inclusion of shareholders' Board member nominees in proxy materials.
- Interestingly, executive pay has been a recurring theme throughout respondents' commentary. Both corporate and activist respondents have pointed out that heightened public awareness of executive pay since the onset of the financial crisis has made investors more vigilant of excessive compensation packages. Many of these respondents believe this will continue to be the case if companies' stock performance is poor and if executive bonuses continue to receive media attention.
- For the overwhelming majority of corporate respondents, the Dodd-Frank Act will not have a significant impact on Board composition, executive pay structures or public relations. That said, many respondents point out that while their specific strategies will not change, there will be a greater sensitivity to potential shareholder conflicts in these areas. A corporate respondent comments, for example, that "the financial crisis and financial reform together have made it really important for companies to rework their public relations."

"It is interesting to note that although more than half of the corporate executives responding state that the Dodd-Frank Act provisions will make them more responsive, very few believe it will change their behavior on the relevant issues."

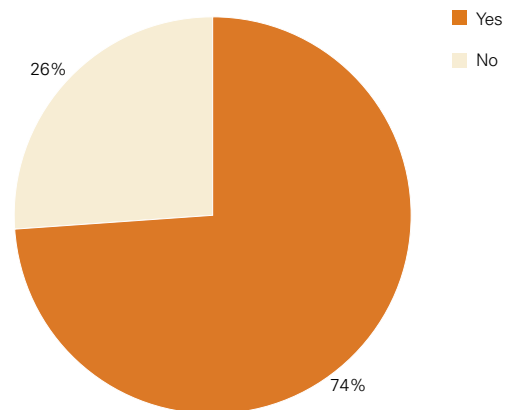
David Rosewater, Partner, Schulte Roth & Zabel

Which of the following rules/regulations will have the greatest impact on your strategy over the next 12 months?



- 'Say on pay' rules, which allow shareholders to weigh in on executive compensation, are identified by close to one-half of corporate respondents as the regulation that will most heavily impact their strategies over the next 12 months. A corporate executive says that in his own company, "when executive compensation goes up, we definitely get more phone calls." Another respondent says shareholders are only concerned with executive compensation "if there is a disconnect between pay and stock performance."
- The elimination of broker discretionary voting is also selected by 36% of respondents, while nearly one-fifth of respondents say that their strategy will be most heavily influenced by the inclusion of shareholders' Board member nominees in proxy materials.

Do you believe it is appropriate for shareholders to have board representation?

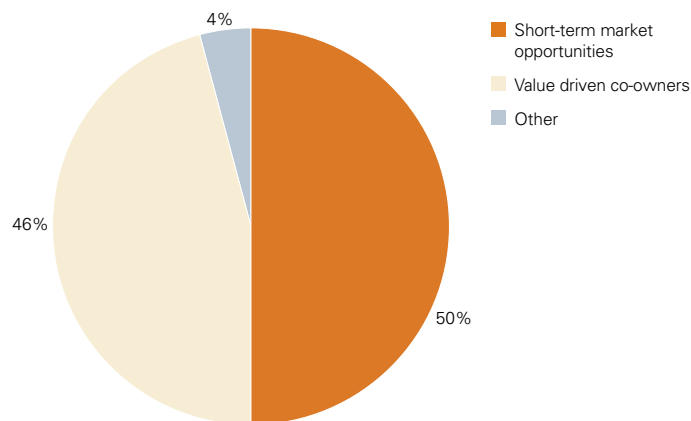


- Approximately three-quarters of respondents believe it is appropriate for shareholders to have board representation. The large majority notwithstanding, there is still one-quarter of respondents who consider shareholder representation inappropriate. A respondent sheds light on this finding by commenting: "Yes and no – it depends solely on the type of investors. If we're talking about retail investors representing, we would probably question whether they have the sophistication. It could be a different case for pension funds."

Study findings

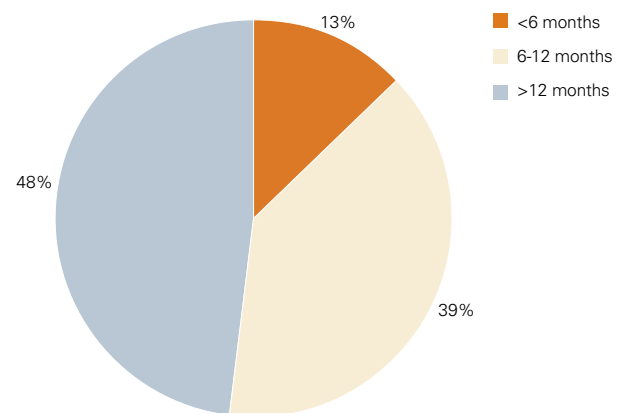
Activists only

What is your overall impression of activist investors?



- Interestingly, corporate respondents are divided over their impression of activist investors, with nearly half describing activists as short-term market opportunists and half describing activists as value driven co-owners. One corporate respondent explains: "It depends on the shareholder in terms of what they bring to the table and what their intentions are. Sometimes there is a feeling that they are politically motivated." Another respondent agrees: "In my own experience shareholders are often politically driven. It's a mix."

What is the average holding period of an activist investment?

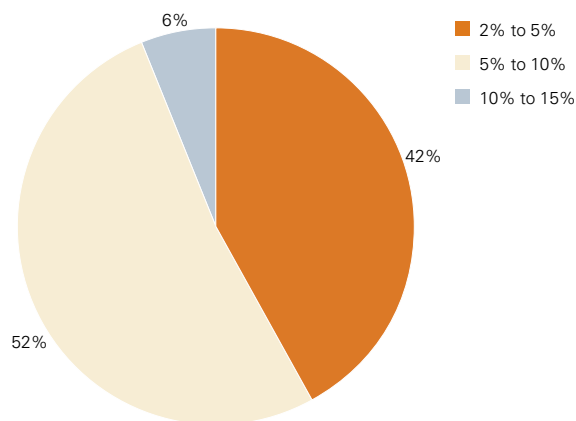


- Nearly half of corporate respondents had described activists as short-term opportunists, but this is not necessarily in sync with activist respondents' strategies as nearly half (48%) of them say they hold activist investments for one year or more. Most remaining respondents hold their investments for six months to one year (39%), and only 13% of respondents hold investments for less than six months.

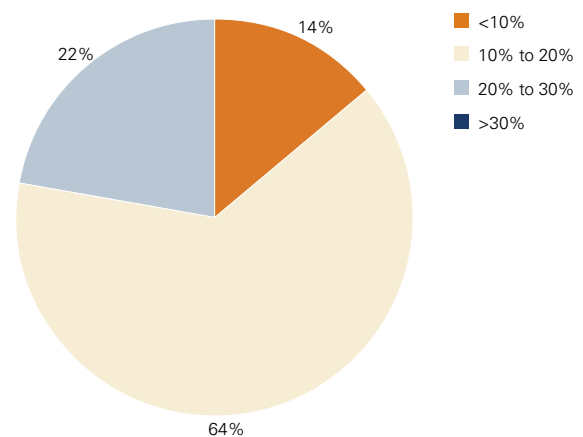
"The fact that corporate respondents' views of activists have improved significantly since 2008 (when only 16% saw them as value driven co-owners) indicates that more companies will take the activists' suggestions more seriously."

David Rosewater, Partner, Schulte Roth & Zabel

What percentage of assets under management are you most comfortable with committing to an activist investment?



What annual returns do you target in activist investments?



- As was the case in the first edition of this report, most activist respondents surveyed are comfortable committing between 5% to 10% of assets under management to activist investments. But on the whole, respondents have become markedly more conservative in their approach to activist investing since the last edition of this survey. Compared to more than one-quarter of respondents (29%) in the previous edition, only a small number of respondents in the current edition say they are comfortable committing between 10% and 15% to activist investments.
- The events of recent years may have tempered activists' expectations for returns. The majority of respondents (64%) say they are targeting annual returns of between 10% and 20%, but these returns were on the lower end of the spectrum in the previous edition, in which 42% of respondents targeted returns in this range and 29% targeted returns of more than 30%. In the current survey, no respondents are targeting returns above 30%; conversely, no respondents to the previous edition of this survey admitted to targeting less than 10%.

"The concentration in the positions held by some activist funds was a major issue, particularly with respect to liquidity, for a number of activists after the 2008-2009 economic downturn, and activists appear to have adjusted their approaches accordingly."

David Rosewater, Partner, Schulte Roth & Zabel

BIG OR SMALL

Clients of all sizes turn to us for help with their campaigns.

Representative activist campaigns include:



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Schulte Roth & Zabel, a full service law firm with 450 lawyers, delivers sophisticated, leading-edge advice to the firm's clients, which include prominent financial institutions, corporations and investors. The firm strives to build and maintain long-term relationships with clients by emphasizing client service. With expertise in a broad array of practice areas, the firm provides comprehensive advice to achieve its clients' objectives.

SRZ is one of the leading law firms in the area of business transactions, including mergers and acquisitions, leveraged buyouts, distressed investments, activist matters, public offerings, high-yield debt issues and PIPE transactions. Clients include both financial and strategic investors.

The firm has a preeminent practice specialty in activist matters, with an unparalleled expertise in the applicable securities laws, proxy rules and the current state of market practice. SRZ has been counsel in many of the highest-profile activist matters in recent years. Serving both issuers and activists, the firm advises on federal securities law, state corporate law, Hart-Scott-Rodino, proxy rules and related matters, as well as handling investigations and litigations arising out of activist activity.

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