THE ACTIVIST INVESTING ANNUAL REVIEW 2018

The fifth annual review of trends in shareholder activism

Activist Insight

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– THE HEDGE FUND JOURNAL

BIGGER THAN EVER

Marc Weingarten and Ele Klein, co-chairs of Schulte Roth & Zabel's global Shareholder Activism Group and Aneliya Crawford, a partner in the Shareholder Activism Group, on what to expect in 2018.

Spurred by an increase in activism in recent years, boardrooms across the globe have begun preemptively taking a closer look at their companies' performance, strategic direction, board composition, and governance practices. Nonetheless, activism shows no signs of slowing down.

Return to large-cap targets

2017 was a headline-grabbing year, as activists increasingly targeted companies with multibillion-dollar market capitalizations in the United States and Europe. More than 21% of all campaigns focused on large-cap companies, up from approximately 19% in 2016. Highlights included Trian Partners' engagements with Procter & Gamble (P&G) and General Electric, Greenlight Capital's engagement with General Motors, Third Point Partners' engagement with Nestlé, as well as Pershing Square Capital Management's bid for board seats at Automatic Data Processing.

This trend is the natural result of an increase in the flow of assets to activist funds based on the success of activist strategies, particularly as a counterbalance to the overall trend of investors shifting toward passive vehicles. The recognition by institutional investors of the benefits of activism has also increased their willingness to lend support, allowing activists to engage even larger companies with performance and operational issues.

Resurgence of the proxy contest

Over the past year, the percentage of publicly announced settlements has declined 6%, as compared to 2016. Emboldened by more aggressive defensive strategies and advice, many companies subject to activism, especially large-cap companies, have been more reluctant to settle.

Some companies have rejected activist overtures out of hand, instead opting for costly and public proxy fights. It is estimated that P&G spent over $100 million in its efforts to keep Nelson Peltz off its board, surpassing previous proxy fight spending records. This strategy, however, has been met with mixed success this year, as activists have achieved partial or full victories in 54% of campaigns that went to a vote.

Backlash against dual class shares

Dual class share structures, where insiders are given control over companies disproportionate to their economic ownership, came under heavy fire in 2017, highlighted by Snap's decision to sell non-voting stock in its initial public offering. Index providers S&P Dow Jones and FTSE Russell announced plans to limit the eligibility of companies with multiple share classes to be included in their major indexes, while MSCI is investigating whether such companies should be barred from inclusion in its indexes.

Following this backlash, Facebook was forced to abandon its plans to create a new class of non-voting shares, while Uber's board voted to switch to a "one share, one vote" structure as it gears up for an IPO. Companies wishing to go public in 2018 will now have to evaluate meaningfully the consequences of using such structures.

Activism outside the United States

While the bulk of activism continues to take place in the U.S., the number of activist campaigns has grown throughout the rest of the world. The European Union adopted shareholder rights directives that encourage shareholder participation, paving the way for increased activism in the future. In Switzerland alone, Third Point took a $3.5 billion stake in Nestlé while Corvex saw success in its campaign to scuttle Clariant's planned takeover of Huntsman.

Across the rest of Europe, other American hedge funds have launched large campaigns, such as the U.K. branch of Elliott Management's campaign at—and eventual truce with—AkzoNobel, while European activists such as TCI Fund Management and Cevian Capital continue to achieve favorable results. Similarly, Asia has seen an uptick in activism. Japan, once thought to be virtually immune to activists, has seen exponential increases in shareholder engagement, leading Prime Minister Shinzō Abe to embrace shareholder activism as part of his plan to initiate corporate governance reform. In keeping with recent years, activism is likely to become more common outside the United States in 2018.

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2017: AN OVERVIEW

Now in its fifth year, the Activist Investing Annual Review is bigger and more thematic than ever, blending commentary from a range of industry players and bespoke data analysis from Activist Insight's suite of products. Activist Insight's editor-in-chief, Josh Black, reflects on a year in activist investing.

If 2017 is known for anything, it will be for the fights. At Procter & Gamble, the largest company to face a proxy contest, Nelson Peltz ended the year with the offer of a board seat after a result that raised questions about how votes are counted at shareholder meetings. At General Motors and Automatic Data Processing, the pendulum appeared to shift away from activists. Arconic highlighted just how close and hard-fought proxy contests at large caps are.

The underlying story is more nuanced. Activist hedge funds generally took on less troubled companies in 2017, while institutional investors stepped up to deal with governance meltdowns. As both issuers and activists learned to engage shareholders, operational and strategic imperatives, as well as diversity and skill-based board composition, came to the fore.

2017: AN OVERVIEW
THE BIG PICTURE

As this report highlights in three consecutive spreads, the trends in activist investing are no longer uniform. This year, fewer companies were targeted; those that were tended to be larger than in previous years.

Activism also took on new forms, a consequence of market forces and high valuations. One of those forms was influencing the structure and outcome of M&A. A third theme was that activism came from unexpected sources as occasional activists and reactive shareholders increased their activity. Outside of the U.S., some countries saw increases in activism, in others it declined.

For some activists, the future looks bright. Despite performance continuing to underwhelm, it seems money is available for co-investments and special projects. Nonetheless, expect to see some fundraising this year as activists look to bask in some of the glow afforded to the fast-growing impact investing sector.

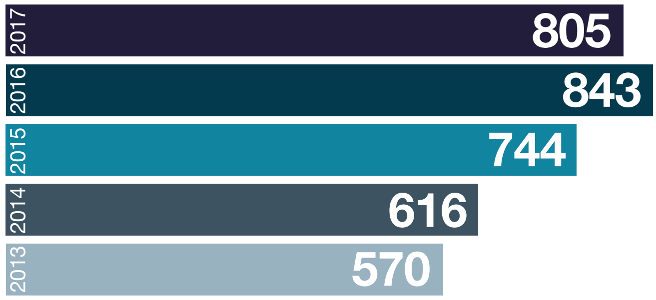
Just as underperforming companies have accepted that they do not always need to fight activists, good companies are not immune from making some changes when an activist's ideas have resonance. That may mean more bets by activists on long-term transformation projects, which – like General Electric – only escalate when the wheels come off. Increasingly, an activist's track record matters. Credibility means not bailing on underperformers, just as much as taking credit for the outperformers.

On a personal note, I am grateful to everyone who contributed to making this Activist Investing Annual Review the best yet, and to our sponsors: Georgeson; MacKenzie Partners; Okapi Partners; Raymond James; and, in particular, Marc Weingarten and Ele Klein at Schulte Roth & Zabel.

As activism becomes ever more varied, Activist Insight's reputation as the most comprehensive provider of information on the space becomes more valuable, not least to us. An overhaul of our website, a second weekly newsletter, new additions to our product suite, and an avalanche of reporting kept us busy in 2017. Needless to say, we have more lined up this year.

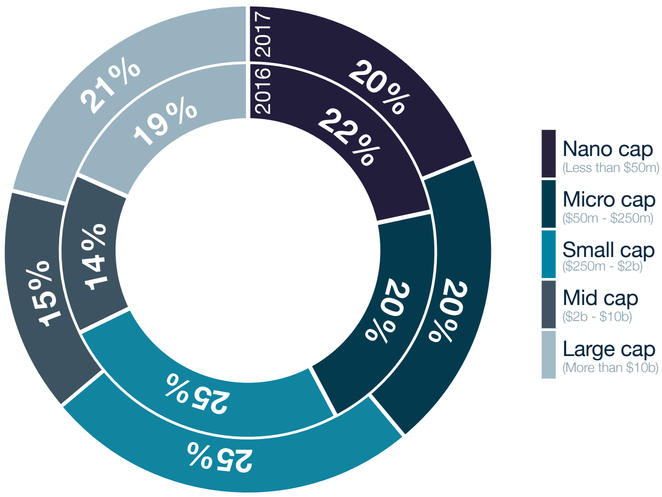
We look forward to working with all our subscribers, and continuing to engage in the debates surrounding activism in 2018.

Targets by year



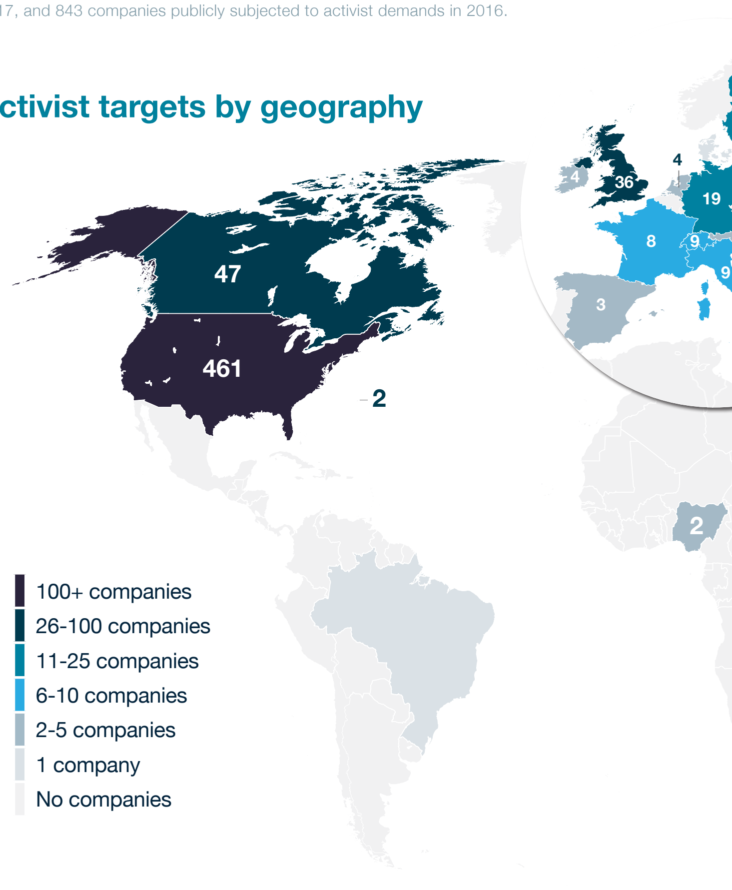
Number of companies publicly subjected to activist demands by year.

Breakdown of activist targets by market cap



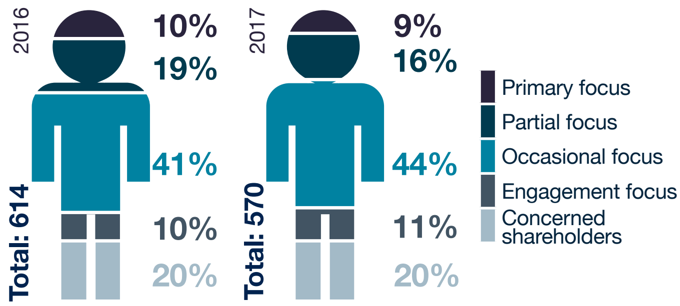
Market cap breakdown of the 805 companies publicly subjected to activist demands in 2017, and 843 companies publicly subjected to activist demands in 2016.

Activist targets by geography



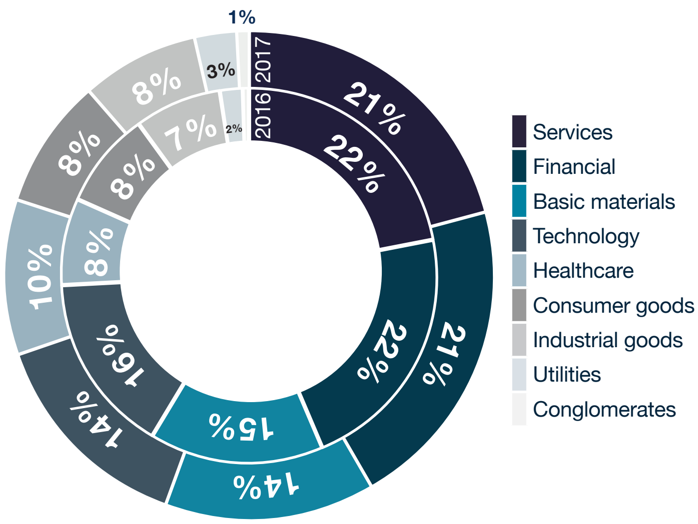
AN OUTLOOK

Active activists by year

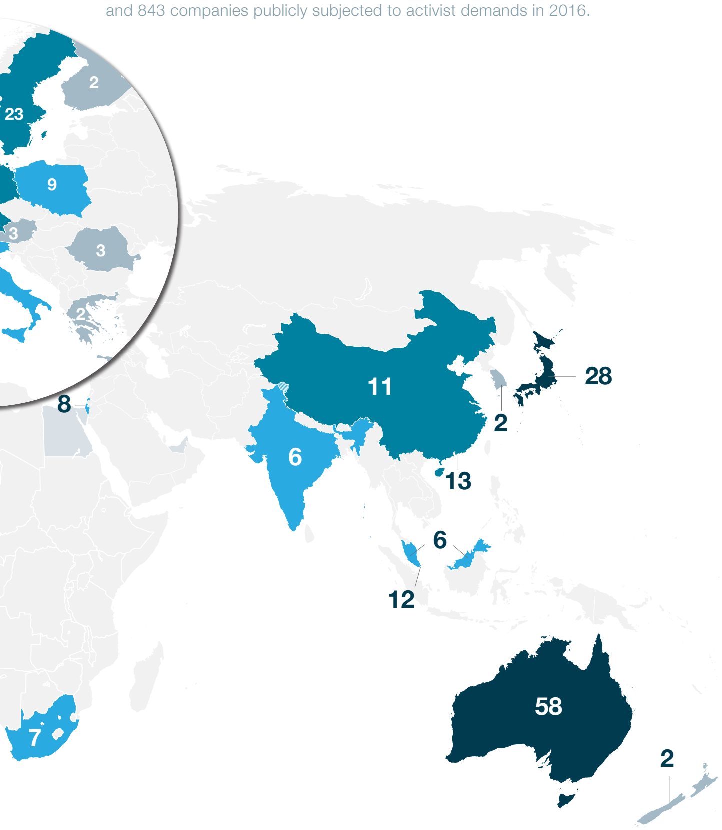


Number of investors making public demands of companies in 2016 and 2017, and a breakdown of those investors by focus type (see page 13 for full definitions).

Breakdown of activist targets by sector



Sector breakdown of the 805 companies publicly subjected to activist demands in 2017, and 843 companies publicly subjected to activist demands in 2016.



Number of companies publicly subjected to activist demands in 2017 by company headquarters.

For 2018, Activist Insight expects to see the following:

To gain currency with the wider investor community and to distinguish themselves from "bad actors," activists will attempt to differentiate themselves based on their track record, expertise, and objectives. In some cases, they will distance themselves from their own history, with new mandates and objectives.

All activists will seek to portray themselves as keenly interested in environmental, social, and governance (ESG) issues. At a minimum, they will talk more about the long-term consequences of their involvement; those who do their homework will criticize companies for specific failings. Institutional investors, bolstered by larger stewardship teams, may seek to pre-empt activist campaigns by becoming increasingly vocal about problem companies.

More activists could look back to existing portfolio positions for alpha, pushing for second proxy fights or further changes as new opportunities grow more limited and riskier.

A correction in the markets will likely be required for activism to break past records. The risk posed by current valuations and a tendency for large, dedicated activists to put ever-larger amounts of capital to work in each investment suggests large caps will be just as vulnerable in 2018, though some more nimble funds will look down-market, where the bulk of activity takes place.

Activists will seek to identify turning points where they can influence company strategies, rather than relying on proxy fights. Those will include CEO transitions, M&A, and urgent board refreshment drives.

Excitement about corporate governance changes in Asia, especially in Japan and South Korea, will continue. The big money, however, will flow to Continental Europe, where M&A will frequently be the catalyst now that political and economic concerns have largely abated.

Short sellers will continue to focus on less liquid markets and bigger impact accusations to counter a rising market. Targeted companies will be watching MiMedx Group for signs of whether a robust rebuttal on an almost daily basis is a better strategy than ignoring allegations.

From Activist Insight, expect to see multiple product enhancements and at least one new product launch. Plus, keep track of conferences we recommend on our events listing page: activistinsight.com/resources/events.

THE MORE MONEY, THE MERRIER

Large caps saw a rise in activist campaigns in 2017, with shareholder activists targeting corporate giants like Procter & Gamble, Automatic Data Processing, and General Motors. The results suggest this trend will continue in 2018.

The past year saw a bustle of activity surrounding the large-cap market, with media attention focused on Bill Ackman's daring fight at human resources company Automatic Data Processing (ADP) and Nelson Peltz's at consumer goods giant Procter & Gamble (P&G), the largest target of a proxy contest and the priciest battle ever. In fact, 167 companies with market capitalizations of over $10 billion were subjected to a public demand by an activist in 2017, representing 21% of all publicly targeted companies. That represented a two percentage point increase on the previous year.

Although contentious situations made the trend even more noticeable, the number of large caps subjected to public demands by primary- and partial-focused activists increased nearly 11% from 36 to 40 between 2016 and 2017, while the overall number of their targets fell, according to data from *Activist Insight Online*.

"One of the interesting stories in 2017 was how well-run, large-cap companies faced activism challenges," said Bill Anderson, Evercore's head of activism and raid defense. "In many of these situations, the activism challenge occurred while the company was transitioning the CEO role. It appears that activists are increasingly targeting companies during these executive transition periods."

Financial firms like Commerzbank, Altaba, and Worldpay Group were more common targets among large caps subjected to activist demands this year, with 38 such issuers targeted. Also heavily picked-over in 2017 were the services and healthcare sectors with 36 and 24 companies targeted, respectively, according to *Activist Insight Online*.

Demands were mostly linked to governance, including board-related matters. *Activist Insight Online* data show that 28% of public activist demands at large caps were board-related and 38% connected to other governance issues – such as using the universal ballot, amending bylaws, or redeeming poison pills. The least popular demand-types at large-cap companies included M&A and balance sheet activism, reflecting a preference for operational and managerial requests, rather than financial engineering.

More activists' demands were unsuccessful after campaigns at large-cap companies in 2017, with 45% of resolved activist demands unsuccessful and 46% at least partially successful, according to *Activist Insight Online* data. In fact, activists technically lost each of the year's three largest proxy fights – General Motors (GM), ADP, and P&G (where Peltz was given a board seat to draw a line under recounts) – while at Arconic, Elliott Management settled for a reduced number of seats after achieving its main objective of ousting CEO Klaus Kleinfeld.

"The sweet spot for activists is still $1-10 billion, where there remains material value arbitrage opportunities and yet still sufficient liquidity," said Darren Novak, executive director at UBS. "The valuations in the U.S. have made larger targets less numerous and more difficult to win for activists."

More large-cap companies have been proactively preparing for activist campaigns and have adopted the motto of "be your own activist," advisers to issuers say. Retail votes still tend to help management, either by voting for their slates or not showing up. And thanks to enhanced engagement approaches, companies have become more comfortable relying on institutional investors to back them.

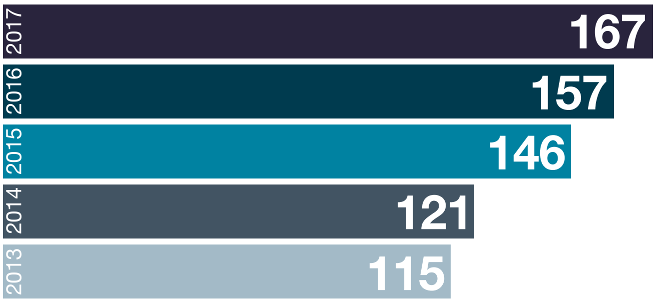
"Directors really have evolved beyond thinking about their business from an activist perspective toward thinking about their business from an investor-centric perspective that takes into account all shareholder constituencies," said Derek Zaba, CamberView Partners' co-head of contested situations.

Trian Partners' ultimately successful campaign for board representation at P&G suggests activists could continue to target large-cap companies in 2018.

If activists are strategic in their initial engagements with companies, they may find boards more willing to work with them in the new year and the number of proxy contests could fall as a result. If not, activists will need to structure their arguments around the performance of companies' board and management teams to win the hearts of other investors.

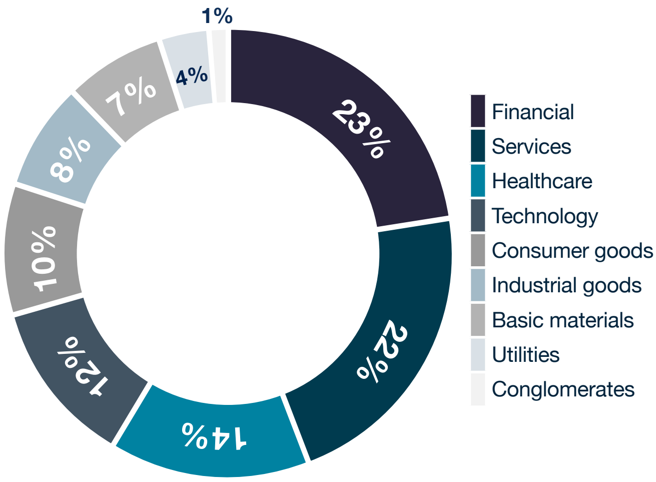
“The sweet spot for activists is still $1-10 billion, where there remains material value arbitrage opportunities and yet still sufficient liquidity.”

Large-cap targets by year



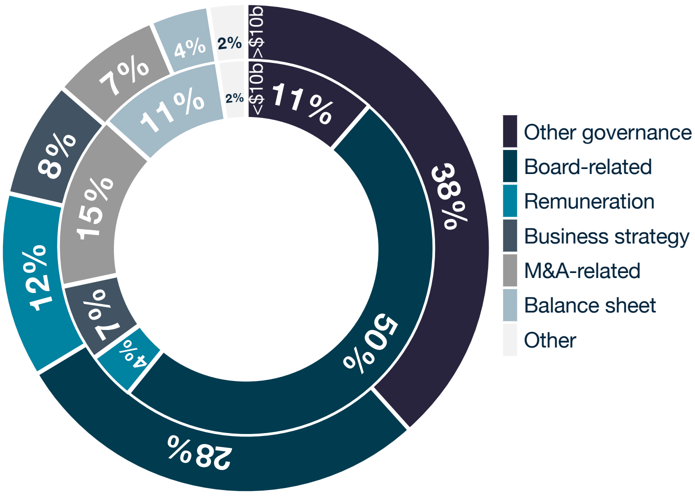
Number of companies with a market caps over $10 billion publicly subjected to activist demands.

Sector breakdown of large-cap targets in 2017



Sector breakdown of companies with a market caps over $10 billion publicly subjected to activist demands in 2017. Note: rounding may lead to summation errors.

Activist demand-type breakdown in 2017



Demand-type breakdown of all public activist demands made in 2017 at companies with market caps above and below $10 billion. Note: rounding may lead to summation errors.

Most active large-cap activists

Number of companies with market caps over $10 billion publicly subjected to activist demands between 2013 and 2017, by activist.

Large-cap companies like General Motors and Automatic Data Processing were activist targets in 2017.

THE M&A BOOM

After a move toward blocking deals in 2016, activists became more collaborative in M&A in 2017. Using deals to push for more comprehensive changes may be the new normal.

A private equity-style buyout, enlisting a bulge bracket investment bank to help it play bumpitrage in a four-way consolidation of the global semiconductor giants, asset sales by resources giant BHP, and holdout stakes in a host of European and Asian countries. Among activist hedge funds, only Elliott Management could involve itself so deeply in M&A in so many places in one year. Yet that snapshot of its activity – involving 11 targets but touching many more – is indicative of the growing importance of activists in transactions.

In May, Activist Insight released its first special report on M&A activism, noting that the number of activist exits through deals with strategic buyers had increased sharply since 2013, perhaps reflecting a growing willingness to use activism as an arbitrage strategy as 2015 and 2016 saw demands aimed at opposing transactions grow sharply. Pro-M&A demands, such as pushing for the sale of a company, dropped during 2015 and 2016, according to *Activist Insight Online*. That may be due to a slightly chilled environment for transactions, as well as growing skepticism about campaigns solely predicated on strategic alternatives or balance sheet changes.

Nonetheless, 2017 saw a tentative reversal of those trends, with pro-M&A activism recovering. Opposition to deals also dropped off. As with Buffalo Wild Wings, where a private equity buyout took place just a few months after Marcato Capital Management won board seats on a platform of operational changes, some offers were too good to turn down. For Elliott, a long-held ambition to own whole companies was fulfilled with the takeover of Gigamon.

Transactions were also hijacked to push for more far-reaching strategic changes in 2017. D.E. Shaw and Jana Partners secured a promise from EQT to review a breakup plan following its merger with Rice Energy – the former demanding such a concession in return for its vote, the latter briefly soliciting against the arrangement.

Trian Partners, Glenview Capital, and Third Point Partners all chimed in on DowDuPont's planned split into three companies and Corvex Management successfully called for CenturyLink to appoint the CEO of its junior merger partner, Level 3 Communications, as its new boss following the completion of the transaction.

In 2018, the incentives for M&A could be even higher. "In a world where companies have done a good job of taking cash out of businesses, driven margins to frankly impressive levels, and right-sized their balance sheets, activists have had to look for other levers, whether that be CEO or CFO change, board change, or M&A," says Steven Barg, co-head of Goldman Sachs' M&A Solutions Group.

> "Transactions were also hijacked to push for more far-reaching strategic changes in 2017."

Bill Anderson, a senior managing director at Evercore, expects "a lot of activism" to be M&A-focused in the new year. "There will be a lot of cash on balance sheets, which will soon be supplemented by tax reform," he explains. "We expect that companies will deploy that cash via M&A, rather than buying back shares with valuations so high."

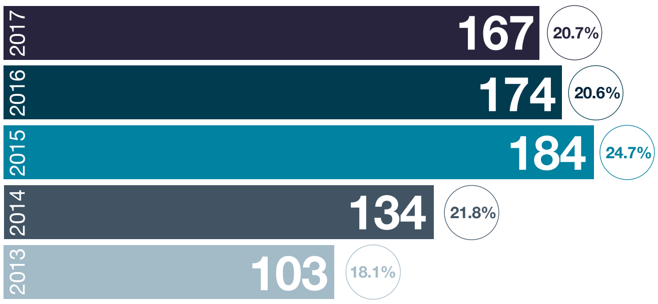
Moreover, management teams are willing to make deals, playing into activists' hands. "Companies are looking to boost growth, cash flow, and margins in a relatively low-growth environment," Barg adds. "Activists are forcing companies to face whether they have the ability to do that organically."

Lower valuations mean European companies like Clariant, whose acquisition by Huntsman was torpedoed by Corvex and 40 North Capital, are likely to be in the crosshairs. In December, Elliott and Knight Vinke piled into Germany energy company Uniper, likely preparing a challenge to a creeping takeover by Finland-based utility company Fortum.

In the Netherlands, AkzoNobel could face renewed pressure from PPG when a cooling-off period expires after barely seeing off a challenge from Elliott over its refusal to engage with its American rival. Qualcomm, meanwhile, faces a proxy fight as part of a hostile takeover bid by Singapore-based Broadcom. In 2018, activism and deal-making may be more synonymous than ever.

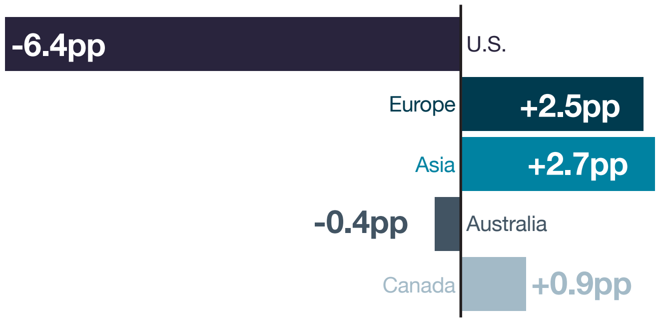
"Lower valuations mean European companies like Clariant, whose acquisition by Huntsman was torpedoed by Corvex and 40 North Capital, are likely to be in the crosshairs."

M&A targets by year



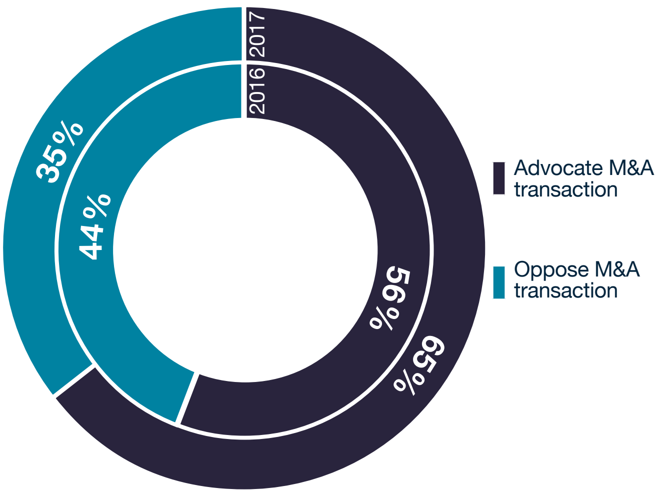
Number of companies publicly subjected to M&A-related activist demands by year, and share of all companies publicly subjected to activist demands in each year (circled).

M&A activism change by region



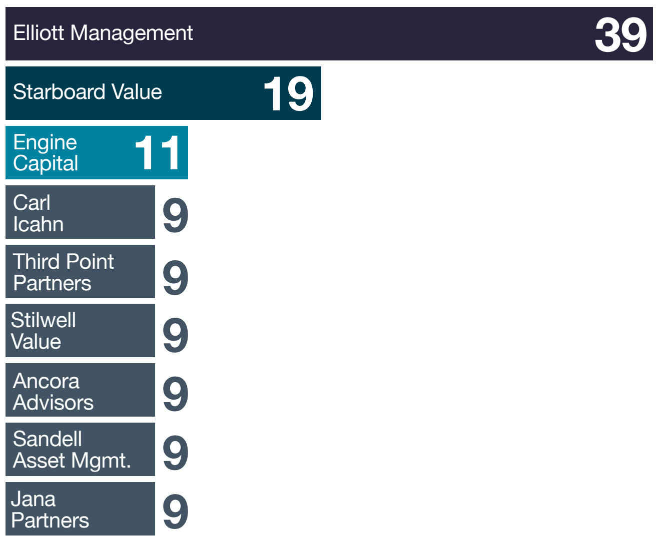
Percentage point change between 2016 and 2017 of companies publicly subjected to M&A-related activist demands by company headquarters.

Breakdown of M&A activist demands in 2017

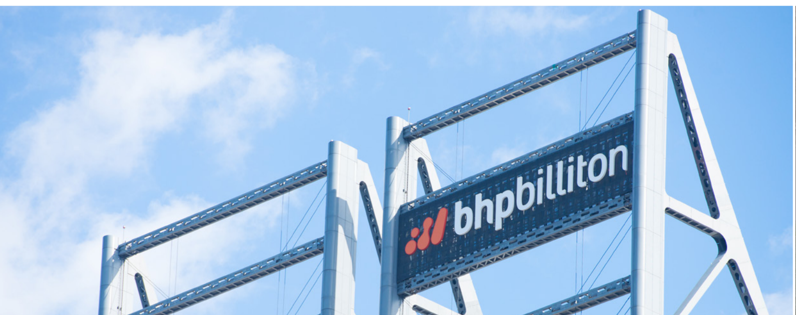


Demand-type breakdown of all public M&A-related activist demands made in 2016 and 2017.

Most active M&A activists



Number of companies publicly subjected to M&A-related activist demands between 2013 and 2017, per activist.



Both BHP and CenturyLink were targets of M&A-related activist demands in 2017.

THE UNUSUAL SUSPECTS

Dedicated activists were less busy in 2017, but global activism continued to thrive, driven by occasional activists and engagement investment firms.

Rising stock markets across the globe, coupled with difficulty finding undervalued targets in the U.S., reduced the impetus of dedicated activists and pushed some abroad in 2017, particularly to Europe. Those activists with a primary or frequent recourse to activism targeted 305 companies worldwide in 2017 compared with 373 in 2016 and 344 in 2015, according to *Activist Insight Online*. Aside from Paul Hilal's Mantle Ridge, there were essentially no new entrants in the space of dedicated hedge fund activism.

At the same time, sitting tight and waiting for poorly performing boards to change their approach is no longer acceptable for a variety of such investors. An increasing number of passive hedge funds see activism as an effective strategy to boost returns, particularly when confronted with long-term underperformance and entrenchment. The likes of Delbrook Capital and Aristeia Capital launched their first proxy contests in 2017, while Arrowgrass Capital campaigned against a merger. Delbrook told Activist Insight that it plans to expand its activism activity in 2018 as it believes the approach has the potential to bring about outsized profits.

Thus, while 2017 represented a better year for investors than those immediately preceding it, 344 companies were publicly targeted by occasional activists and concerned shareholders (which use activist strategies infrequently or as a "one-off," respectively), a slight fall from 2016's total of 359, but up from 305 companies in 2015.

Whereas dedicated activists are collectively downsizing their efforts, engagement funds – typically large institutions that lobby for governance changes – are becoming more vociferous. Companies such as Wells Fargo and Tesla bowed to public pressure to appoint new board members, while proxy access bylaws continued to feature heavily in shareholder proposals, even as adoption across the S&P 500 Index became widespread.

Index funds that do not have the luxury of exiting a stock, such as BlackRock, Vanguard, and State Street, bolstered their governance teams last year in light of pressure from their own investors. In addition to expressing disapproval by voting against directors and executive pay packages, engagement activists advanced their own proposals, typically to improve governance by eliminating staggered boards and dual-class share structures, among other things.

"Our asset stewardship team has a long history, but it has definitely grown in size in recent years," Matt DiGuiseppe, State Street's head of stewardship for the Americas, told Activist Insight. "There's definitely more interest from our clients in the work we are doing on their behalf and the focus on transparency provides us with a great opportunity to share and demonstrate our impact," DiGuiseppe believes the upward trend of shareholder stewardship is set to continue in the coming years.

"Rising stock markets across the globe, coupled with difficulty finding undervalued targets in the U.S., reduced the impetus of dedicated activists and pushed some abroad in 2017, particularly to Europe."

Neuberger Berman has taken its engagement practice a step further, regularly making public demands and even launching proxy contests. The investment firm, with $271 billion in assets under management, embarks on contested solicitations only in "extreme cases" where issuers refuse to engage amicably. "We are not searching for activist situations particularly," Joseph Amato, president and chief investment officer at Neuberger Berman, told Activist Insight. "We're searching out companies that we think represent good long-term investments. There are times when we get involved and believe going public with our view is the most constructive way to change." Amato says the fund always engages with the companies it owns and its managers "regularly assert their point of view."

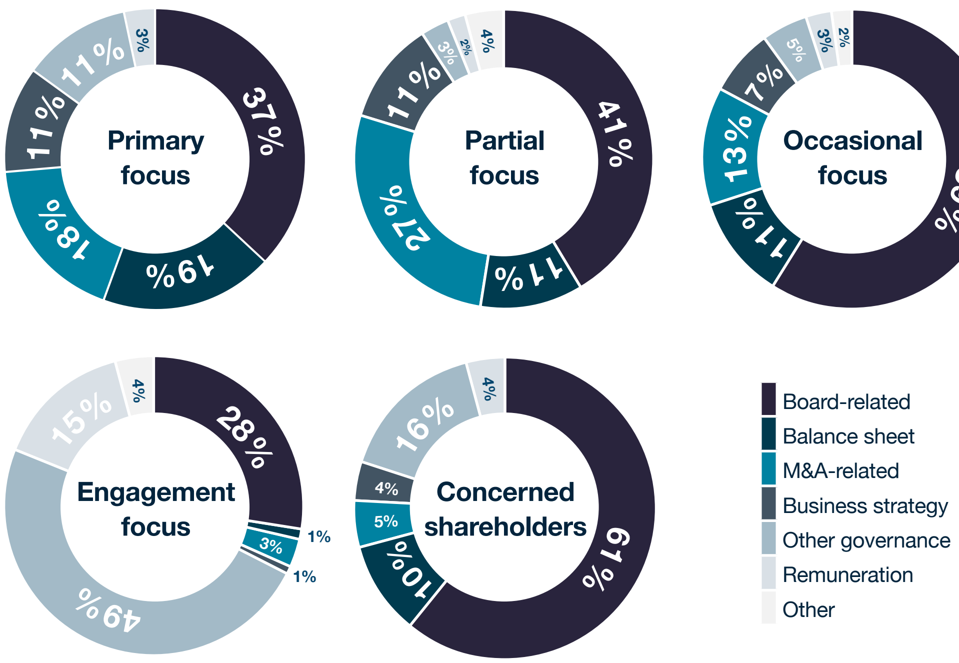
If activism can broaden in times of rising markets, a scenario in which funds become more reluctant to engage seems hard to imagine. The rise of index funds and ongoing consolidation of the hedge fund industry may make it harder to break increasingly high barriers to entry for those hoping to run a dedicated activist portfolio. But a variety of existing investment firms may continue to expand their activism practices in order to improve portfolio performance and halt outflows.

“If activism can broaden in times of rising markets, a scenario in which funds become more reluctant to engage seems hard to imagine.”

Number of activist targets by focus level in 2017

Number of companies that activists of each focus level (see definitions, below right) publicly subjected to activist demands in 2017. Note: the sum of these figures does not represent the total number of companies publicly subjected to activist demands by year, as some companies may have been subjected to activist demands by more than one activist with different focus levels.

Demand-type breakdown by focus level in 2017



Demand-type breakdown by activist focus level in 2017 (see definitions, right). Note: rounding may lead to summation errors.

Definitions

Primary focus:
A fund or individual which dedicates most, if not all of its assets to activist positions.

Partial focus:
A fund or individual which often employs activist tactics yet also uses other investment strategies.

Occasional focus:
A fund or individual that adopts an activist stance on an infrequent basis.

Engagement focus:
Typically large institutions and individuals that rally for change to promote good corporate governance.

Concerned shareholders:
An individual or group of individuals who collectively form a group of shareholders to enforce change, typically as a ‘one-off’ situation.

Rapier Gold and Weibo-owner Sina were two of 254 companies targeted by ‘occasional focus’ activists in 2017.

TARGETS LESS WILLING TO SETTLE IN 2017

By Duncan Herrington, managing director and head of activism response and contested situations at Raymond James.

In 2017, activism targets were less inclined to settle as frequently or as easily in response to activist demands. During the preceding three years, settlements in U.S. campaigns where activists sought board representation had increased sharply, according to data from Activist Insight; however, this trend reversed last year as the number of settlements dropped to its lowest since 2014.

One potential reason for this development is the increasing influence of large institutional investors who have weighed in on this topic. For example, in 2014, ValueAct founder Jeff Ubben notably suggested that in the face of potentially destructive activist campaigns, "Companies might want to push back more because there is some bad behavior going on." In 2015 and 2016, the CEOs of both BlackRock and Vanguard expressed that companies should focus on long-term value creation over short-term objectives, and in late 2016, State Street echoed these sentiments, suggesting that companies should not be so quick to acquiesce to activist demands.

> "These much larger companies typically have greater resources to resist an activist relative to their smaller-cap peers."

A second possible reason is the resurgence last year of prominent activist funds launching campaigns against very large-cap companies. These much larger companies typically have greater resources to resist an activist relative to their smaller-cap peers, such as a sizeable cash stockpile, larger finance and investor relations departments, and an array of financial, legal, and other advisors. As a result, a number of these campaigns escalated to high-profile proxy fights garnering substantial media attention – e.g., Automatic Data Processing (Pershing Square), General Motors (Greenlight) and Procter & Gamble (Trian), to name just three.

As a result, the average length of time between the public launch of an activist campaign at larger U.S. companies and the announcement of a settlement increased in 2017.

Finally, a number of sources last year noted the increased willingness of activists to adopt more aggressive tactics, particularly to single out and publicly criticize a target company's CEO, as well as call for his or her removal – e.g., Arconic (Elliott), Buffalo Wild Wings (Marcato), and Rent-A-Center (Engaged Capital). Given the potential impact of a change of this nature, and the risk and uncertainty involved, targets may have been less willing to adopt a "what's the harm?" approach in response to such demands.

So how successful were these companies ultimately? The statistics, comparing 2017 U.S. proxy fights for board seats to 2016, suggest mixed results. Overall, the issuer win percentage improved but only slightly, with the decrease in settlements being largely offset by a greater percentage of dissident wins in contested shareholder votes.

If we break down this data by target market capitalization, the success rate did improve significantly for the largest ($2 billion and over) and smallest ($50 million and below) companies. On the other hand, for companies in between these two groups, the proportion of campaigns either lost at the voting box or settled in advance of the vote increased significantly last year.

These results suggest that as activists who attack mid-size companies become increasingly sophisticated in the tactics they employ, mid-size companies will need to be more prepared, including having a response plan and team in place before an activist launches a campaign, in order to improve their chances of success in line with their smaller and larger-cap peers.

THE ACTIVIST TOP 10

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, comprehensively derived from the *Activist Insight Online* database. The following categories have been used to create a points-based ranking of each activist for this year's list: number of companies publicly subjected to activist demands; average market capitalization of targeted companies; success of public demands; average 2017 annualized Total Follower Return* of companies subjected to public demands; and news stories written about the activist on *Activist Insight Online* in 2017. To qualify, an investor must regularly employ an activist strategy and have publicly targeted two or more companies in the past year.

*Total Follower Returns is a calculation of stock price change percentage plus dividends paid from the first close in 2017 or, if the investment was disclosed in 2017, the close on the date an activist's first involvement is disclosed until the sooner of the last close in 2017 or the date an activist discloses that they have exited the position.

01 ELLIOTT MANAGEMENT

Companies publicly subjected to activist demands	21
Average target market cap	$11.7B
Average annualized total follower return	13.6%
Activist Insight Online news stories (2017)	298

AkzoNobel and Arconic were both the subjects of Elliott Management's activist advances in 2017.

With 21 companies subjected to its public demands across nine countries, Elliott broke its own record in 2017. That its campaigns included a no-holds-barred proxy contest at Arconic, where it secured board changes and the departure of CEO Klaus Kleinfeld in a climactic twist, and full-throated legal and media fights at the Netherlands' AkzoNobel and Anglo-Australian resources giant BHP should leave no-one questioning its capacity. Lost in the Arconic fight, which came to be seen as a personal grudge match with Kleinfeld, was the level of operational depth in Elliott's approach. The fund released five presentations over the course of the fight, totaling 472 slides. That has helped the activist keep pace with demands from the stewardship industry to focus on long-term value creation. As the test inches toward more environmental, social, and governance demands, the depth of Elliott's resources will no doubt be trained on those areas.

The multi-strategy fund's level of activity has a lot do with its decentralized organization. Activist ideas can come from the firm's London or Hong Kong offices. Separate activist funds run by ex-Elliott managers may soon rival the number of offshoots from Pershing Square Capital Management or Icahn Associates.

Early indications suggest Elliott will be ploughing the same furrow going into 2018, seeking constructive relationships with management where possible and prosecuting change ruthlessly when it thinks management is stalling. "We strive for consistency of process," Jesse Cohn, the fund's head of equity activism, told Activist Insight for this report. "It's the companies that are different each time." Having bought one company outright in 2017, more may follow in 2018, though Elliott's Menlo Park-based private equity vehicle Evergreen Coast Capital is understood to be focused on prudence, rather than deals for deals' sake.

As to which sectors or stocks will cross Cohn's desk, it could be too soon to say. Guides to the markets for this year are nothing if not speculative and Elliott's universe is almost unlimited. "We run fully hedged and assuming the world can go in many different directions," Cohn concludes. "I think there will be things for Elliott to do in any of those directions."

“We’ve worked very hard over a long period of time to build credibility with all constituents – shareholders, management teams, boards, and advisers – regarding our ability to fix and grow companies.”

02 TRIAN PARTNERS

Companies publicly subjected to activist demands	2
Average target market cap	$192.8B
Average annualized total follower return	2.3%
Activist Insight Online news stories (2017)	99

Adding directors at two companies with market caps of more than $150 billion in 2017 was a new departure even for Trian, with Ed Garden joining the board of General Electric amid a crisis of confidence in the storied industrialist and Nelson Peltz to be appointed to the board of Procter & Gamble (P&G) in March after the most expensive proxy fight in history ended in a de facto draw. That Trian now holds board seats at all eight of its portfolio companies without standstill agreements is testament to the duration of its campaigns and its ruthless focus on income statement activism.

“We’ve worked very hard over a long period of time to build credibility with all constituents – shareholders, management teams, boards, and advisers – regarding our ability to fix and grow companies,” Garden, the fund’s chief investment officer, told Activist Insight for this report. “We have also worked hard to build the quantum and duration of capital required to get the job done.”

Despite an all-consuming year and high valuations, Garden did not rule out a new campaign in 2018. “We have a pipeline we’re very excited about,” he says, adding that a universal proxy rule and reform of the proxy plumbing following P&G’s exhaustive recounts would make Trian’s year.

03 THIRD POINT PARTNERS

Companies publicly subjected to activist demands	4
Average target market cap	$116.9B
Average annualized total follower return	18.5%
Activist Insight Online news stories (2017)	59

With a host of big new investments in 2017, including Nestlé, Honeywell, and Macerich, Dan Loeb’s Third Point Partners seems well-placed to have a busy year in 2018. A bet on margin enhancement at the European confectioner looks set to gain special attention from new CEO Ulf Mark Schneider, even if a sale of its stake in L’Oréal is seemingly off the table, while Honeywell has also resisted a drastic breakup in favor of incremental steps toward greater focus. Both companies are repurchasing shares in large quantities, which should please the activist.

Less publicized, Baxter International continued to be a big contributor to returns for the second year running. The medical devices maker has not looked back since spinning off Baxalta, which was acquired by Shire last year. Last April, Third Point used a quarterly investor letter to declare, “Opportunities for activist and constructivist investing are robust.” Little has changed since.

Whether Third Point brings more of its activism back onshore in 2018 (alloyed with a more temperate approach to underperformance) or builds on the platforms it has established in Europe and Japan will be one of the big questions it has to face next year. Helping to bail out troubled Toshiba at the end of 2017 may mean the choice is forced on Loeb and co.

04

AMBER CAPITAL

Companies publicly subjected to activist demands	10
Average target market cap	$2.3B
Average annualized total follower return	18.7%
Activist Insight Online news stories (2017)	32

One of a rare breed of activist investors operating in Southern Europe, in 2017, Amber's 2-year-old activist fund expanded its focus with headline-making campaigns in Greece, France, and Spain. The Joseph Oughourlian-led fund pushed Greece's main telecom operator OTE to restructure and return capital to shareholders, potentially starting a battle with Germany's Deutsche Telekom, the company's largest shareholder. Amber was also instrumental in removing the long-standing chairman of Spain's Grupo Prisa, Juan Luis Cebrián, while its attempts to block takeovers of Italy's Parmalat and Caltagirone Editore have so far been successful. Indeed, holdout positions at Parmalat and Ansaldo STS may even be resolved in 2018.

Despite a growing number of public campaigns, much of its activism does not reach the limelight, Amber's corporate governance specialist, Arturo Albano, told Activist Insight. "We always try to establish a constructive relationship and dialog with the companies we invest in and most of the activity takes place behind closed doors through engagement, without the necessity to launch public campaigns."

Amber is constantly looking for new opportunities in Southern Europe, Albano adds, although Italy is likely to remain its core market. "We think the Italian legislative framework offers the most effective tools for minority shareholders to play an active role," he says.

Greece-based OTE and printer manufacturer Xerox were targets of activists at spots number four and five, respectively.

05

CARL ICAHN

Companies publicly subjected to activist demands	4
Average target market cap	$2.5B
Average annualized total follower return	28.2%
Activist Insight Online news stories (2017)	89

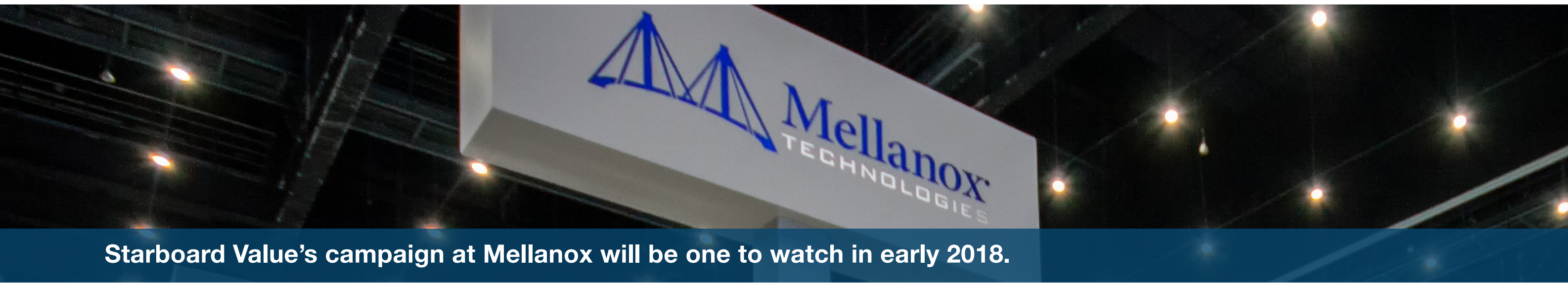
In activism, Icahn had a quiet year as his well-known skepticism about valuations led him to sever ties with several of his portfolio managers, including son Brett and David Schechter, who had earlier been negotiating new deals. As a result, few new investments were made, and a reported bet on Bristol-Myers Squibb, perhaps inspired by the hiring of Richard Mulligan from Harvard Medical School, was puzzlingly low on fireworks. For the career of ex-American International Group (AIG) CEO Peter Hancock, however, Icahn's involvement was reportedly fatal.

In politics, the year was decidedly more exciting. Icahn resigned as a regulatory adviser to President Trump before the publication of a New Yorker article alleging attempts to push for a change at the Environmental Protection Agency that would have benefited Icahn's portfolio company CVR Energy.

That episode, and some Democrats' attempts to impugn Icahn's motives, appear not to have slowed down Icahn's activism. As of December, Icahn is back at full volume, with campaigns at SandRidge Energy and Xerox possibly setting the stage for two proxy contests. Without a correction, however, Icahn may be more focused on buying companies that fit his interests, than pressuring big game into changes.

06 STARBOARD VALUE

Companies publicly subjected to activist demands	7
Average target market cap	$3.9B
Average annualized total follower return	9.5%
Activist Insight Online news stories (2017)	69



Starboard Value's campaign at Mellanox will be one to watch in early 2018.

2017 was fairly quiet for Starboard Value compared to previous years. The activist successfully pushed for the sale of Parexel International, began advocating for "substantial change" at Mellanox Technologies, and urged Monotype Imaging to return to its stronger font business instead of pursuing emojis.

Overall, the number of companies at which Starboard called for change in 2017 decreased to seven from eight in 2016, while most engagements proved less contentious than previous years, potentially meaning more demands were made behind closed doors. In 2017, Starboard settled with a handful of companies, gaining board seats at the likes of comScore, Depomed, and Perrigo, among others.

The big question of 2018 may be whether Starboard continues to find opportunities in its mainly U.S.-based universe. The firm's founder and CEO, Jeff Smith, had previously said that President Donald Trump's tax reform – specifically the tax breaks for companies that earn profits overseas – are potential key ingredients to Starboard's future success.

07 MARCATO CAPITAL MANAGEMENT

Companies publicly subjected to activist demands	6
Average target market cap	$2.2B
Average annualized total follower return	10.2%
Activist Insight Online news stories (2017)	89

Lifting and material handling company Terex was one of Marcato's best performing investments in 2017.

2017 marked a year of highs and lows for Marcato Capital Management, which gained widespread media attention for its proxy contests at Buffalo Wild Wings and Deckers Outdoor. At the former, a sports bar-like restaurant chain, Marcato yielded a major win with three board appointments, CEO Sally Smith's retirement, and a sale of the company to Roark Capital Group.

Yet it suffered a heavy loss at Ugg boot-maker Deckers Outdoor, even after it shrunk its nine-person slate to three. The value-focused investment firm touted an average annualized Total Follower Return of 10.2%, helped by the great performance of its holding in Terex, where it won a board seat in February. In September, Marcato's founder Mick McGuire praised Terex's CEO John Garrison, saying he was the kind of person an activist wants to encounter.

Going into 2018, Marcato remains one of the most carefully watched funds among the new generation of activists, with issuers, shareholders, and analysts anticipating its next move. Marcato will likely want rapid movement at portfolio companies Element Fleet and Rent-A-Center, given that it called for the sale of both companies last year.

08

JANA PARTNERS

Companies publicly subjected to activist demands	6
Average target market cap	$24.1B
Average annualized total follower return	5.9%
Activist Insight Online news stories (2017)	71

In a year of increased M&A activity, Jana Partners fell short at EQT as the natural gas producer and its merger partner Rice Energy won shareholder support for the transaction despite the activist's staunch opposition. Jana withdrew its withhold campaign six days before the deal went to a vote, later cutting its stake despite the company's promise to review a breakup plan. Elsewhere, Jana saw great success, gaining board seats at five companies including Bristol-Myers Squibb, Tiffany & Co, and Conagra Brands. Most notable, however, was Jana's investment in Whole Foods Market, where the activist yielded a quick win as it pushed for a sale of the company. Once Whole Foods announced Amazon would acquire the business, the activist sold its stake for a roughly $370 million profit.

In addition, the start of 2018 saw Jana investing in Israeli pharmaceutical company Teva, launching a new impact investing fund and partnering with pension fund California State Teachers Retirement System (CalSTRS) to push tech giant Apple to develop more parental controls on its iPhone. In a recent interview with CNBC, the $5 billion fund's founder Barry Rosenstein said Jana "is more invested today than we've ever been."

09

OASIS MANAGEMENT

Companies publicly subjected to activist demands	7
Average target market cap	$644M
Average annualized total follower return	25.4%
Activist Insight Online news stories (2017)	46

Oasis Management's activism spanned three continents in 2017, seeking appraisal rights in the takeover of Japan's PanaHome, and picking up board seats at U.S.-based Stratus Properties and Britain's Premier Foods. In the coming years, Oasis expects to expand in Asia, potentially venturing into South Korea, where it sees "momentum picking up around corporate governance."

Oasis Chief Investment Officer Seth Fischer told Activist Insight that the fund will continue to be involved in several strategic positions in the U.S., while in the U.K. it is prepared to use "aggressive tactics only if the issues are particularly grievous or management has chosen not to engage in a cooperative and reasonable approach." At Japan's Katakura Industries, Oasis lost a vote to enhance the company's focus on its return on equity, despite support from Institutional Shareholder Services and many independent shareholders. Oasis proclaimed the results a "victory for the Japanese Stewardship Code." The activist also gained board representation at Hong Kong-based Yingde Gases while the company's founders battled for control before the industrial gases company sold itself to a private equity firm.

10

ALLAN GRAY

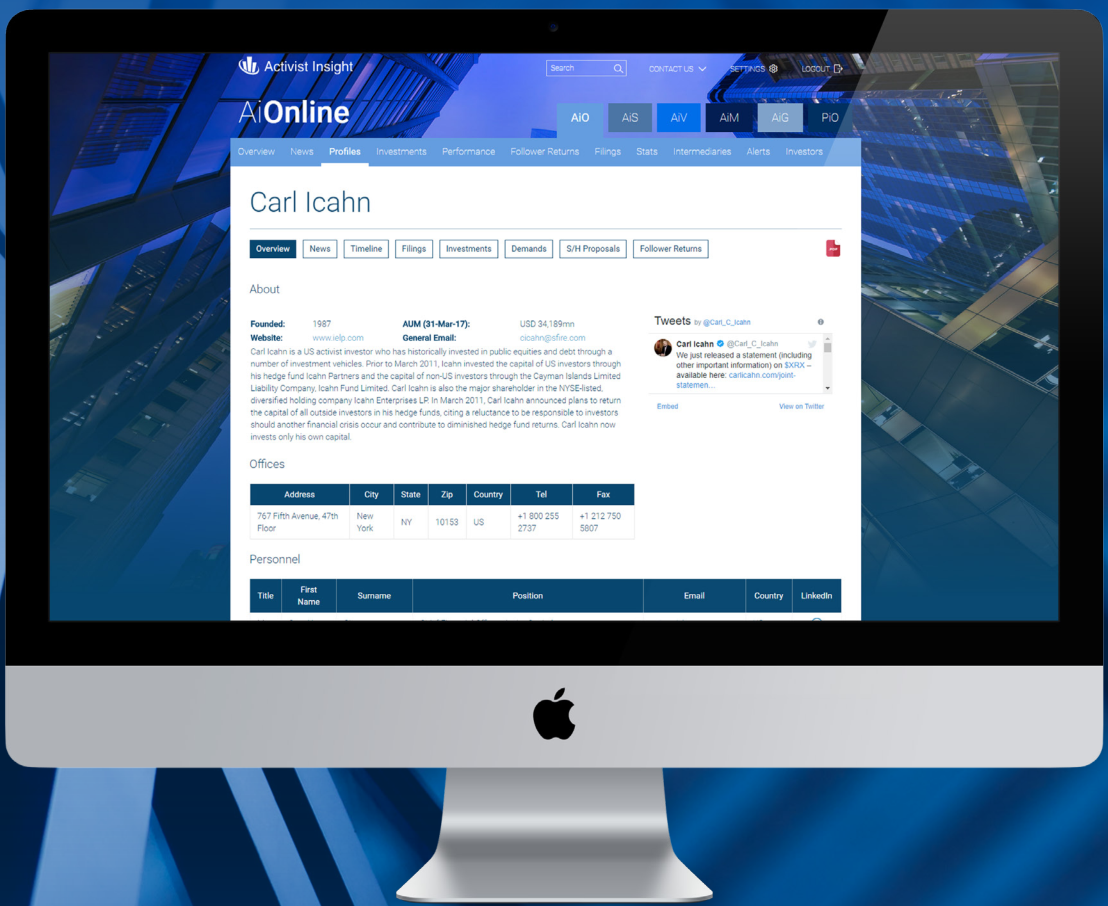
Companies publicly subjected to activist demands	4
Average target market cap	$22.9B
Average annualized total follower return	18.3%
Activist Insight Online news stories (2017)	28

The eponymous investment vehicle of South African magnate Allan Gray falls into the category of reluctant activist – applying pressure only when it sees misconduct on the part of boards and management teams. In 2017, the 30-year old asset manager played a role in the proxy contest at Arconic, criticizing the issuer's corporate governance and publicly backing Elliot Management in its proxy contest, which ended in the departure of CEO Klaus Kleinfeld and a settlement.

On its home turf, faced with few more aggressive peers, Allan Gray was forced to become more active itself. The asset manager was instrumental in replacing the entire board of Group Five, paving the way for asset sales. Meanwhile, payment solutions provider Net 1 Ueps Technologies added an independent director after pressure from the fund.

In 2017, Allan Gray Portfolio Manager Andrew Lapping made a call to arms against poor corporate governance and a lack of accountability in boardrooms. Nonetheless, the reluctant activist will have its work cut out in the year ahead following recent corporate scandals in South Africa, including possible accounting fraud at Steinhoff International.

Activist Insight Online



The most comprehensive coverage of activist situations worldwide

Activist Insight

CREATE VALUE, OR ELSE

Q&A with Bruce Goldfarb, president and CEO of Okapi Partners.

Was 2017 a blip or is winning a proxy fight harder than ever for an activist?

We actually think shareholders across the board are more receptive to ideas from activist investors than ever before. But investors are also more thoughtful in how they evaluate director candidates and proposals put forth by activist investors. In addition, boards and management teams are better at honing their message to shareholders and coming up with innovative strategies to reach them. Whether you're an activist running a proxy fight or a company defending yourself, you have to come well prepared with a dynamic and thoughtful strategy and be able to execute right away.

> "As index funds' holdings have grown dramatically, the fact that their positions are 'built to last' has given them an incentive to become more assertive."

Are more proxy battles being won by better engagement before they've even kicked off?

It really depends on the activist investor, the shareholder base and how well (or poorly) the company has performed. In many cases, an activist identifies an underperforming company and approaches management with ideas about how to improve operations and growth. Many boards and managements have been receptive to ideas and some ideas have been adopted, but all too frequently companies dig in their heels and resist criticism. That dynamic sets the stage for a public battle and often a proxy fight to replace board members and sometimes target members of management.

What, if anything, has changed about how passive owners approach activism?

As index funds' holdings have grown dramatically, the fact that their positions are "built to last" has given them an incentive to become more assertive. The managers recognize that, while they may not be able to use the active management of investment positions to create value, they can urge companies to enhance value through more policies considered investor-friendly. In the past few years, this realization has led BlackRock, Vanguard, State Street and other index fund managers to express a more active – almost activist – attitude toward corporate boards and other environmental, social, and governance (ESG) issues. All of these factors have led to a greater acceptance of activist hedge funds by passive shareholders.

How important are ESG issues to activist campaigns?

There has been a general focus on governance and diversity in the boardroom for some time. But companies in nearly all sectors will see increasing demands from investors to address environmental and social issues. One example was ExxonMobil's annual meeting in May. The New York State Common Retirement Fund put forth a proposal forcing the company to publish an annual assessment of the impact of global climate change policies and that was approved by more than 62% of ExxonMobil shareholders. Among the large investors believed to have supported the proposal – over the objections of the company's board – were BlackRock, Vanguard, and State Street – some of the largest asset managers in the world.

Are non-traditional activists still lining up to run campaigns?

Yes, on a limited scale and these campaigns will be well-considered. While non-traditional investors like mutual fund managers have dipped their toes in the water, the ones who have done so also realize how time consuming and expensive it is to run a proxy contest.

What are some of the likely hot topics for 2018?

Value creation will be the biggest theme. We'll probably continue to see a lot of activity in different sectors of the market. We may also see activists try to replace management at certain companies where they've been active before, but haven't seen the value creation they were looking for or feel management hasn't properly executed on their plan.

PUSHING PAST POOR PERFORMANCE

Even though activist funds revealed poor performance and low returns in 2017 compared to the total returns of the S&P 500 and MSCI World indexes, analysts are still optimistic that 2018 will bring better fortune for these activist investors.

A disappointing finish

Activists' strong performance against major indexes in 2016 gave investors in their funds hope that the following year would produce the same results. However, analysts and shareholders soon learned that the 2017 market disfavored firms that leaned toward a value bias, as activists do. While the total returns of the S&P 500 and MSCI World indexes soared, activists lagged behind, resulting in significantly worse performances for the year compared to other indexes.

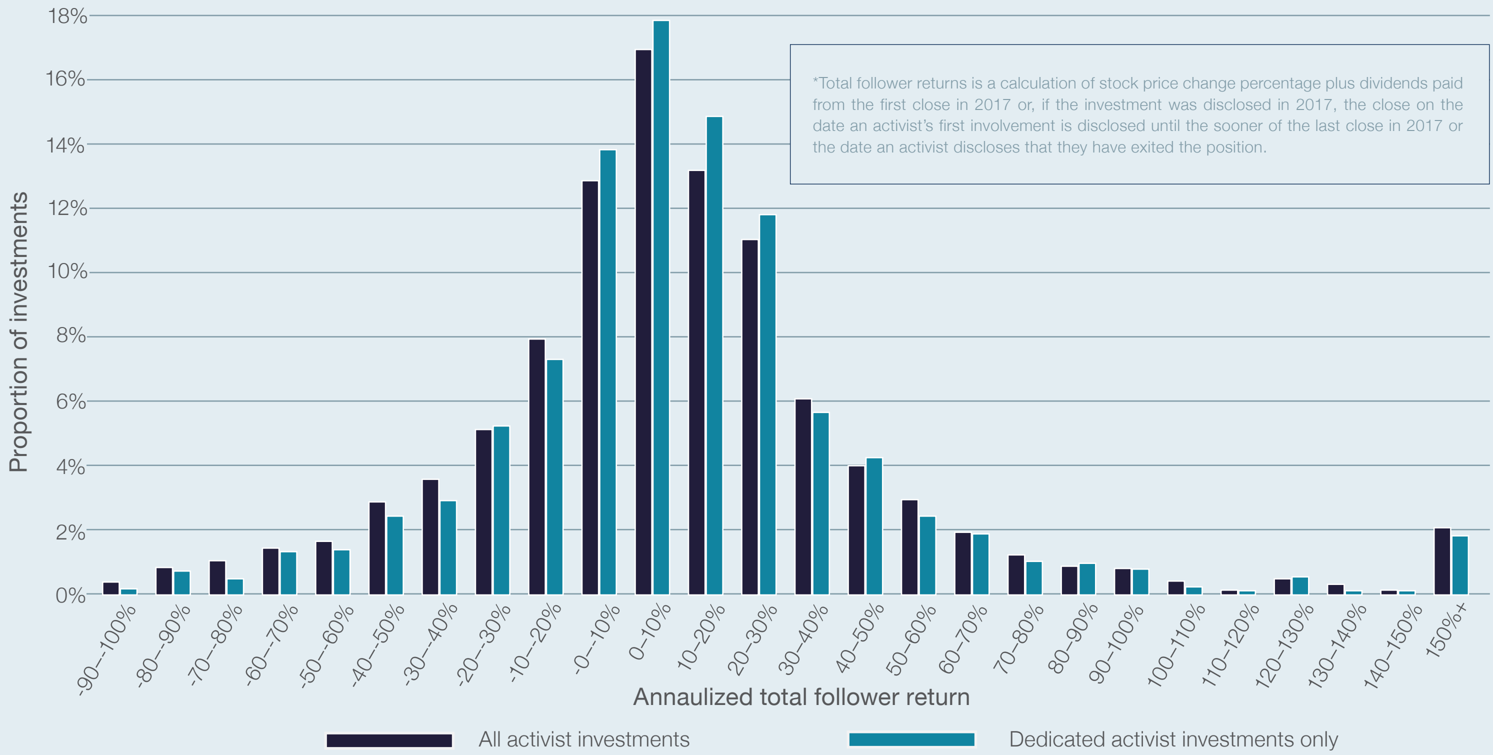
Specifically, the Activist Insight Index had returned 10.7% net of fees by the end of the third quarter of 2017 – the latest period for which full results were available – falling short of the S&P 500 Index total return by 357 basis points and the MSCI World Index total return by 585 basis points – a pronounced gap even after taking into account the fees that would be associated with tracking either index.

Stock performance

According to *Activist Insight Online*'s follower returns stock-tracking feature, the average annualized total follower return from an activist-owned stock was 13.2% in 2017* – lagging the S&P 500 Index, which produced a total return of 21.8%. Funds with a dedicated activist strategy did slightly better, returning an average annualized 15.5%. In addition, approximately 64% of dedicated activist targeted stocks ended 2017 higher than the beginning of the year, and almost 41% of targeted stocks beat the S&P 500 Index total return during the activist's holding period.

Activists performed well in the health, technology, and industrial goods sectors, with average annualized total follower returns of 36.8%, 23.5%, and 20.3%, respectively. Meanwhile, the energy and retail sectors were not as stable, causing activists to suffer from investments in cash flow-

Annualized total follower returns* (%) of activist investments in 2017



> “All signs point to a market that has less upside potential and if that’s the case then operational differentiation is the key, and that’s the direction I think activism is headed.”

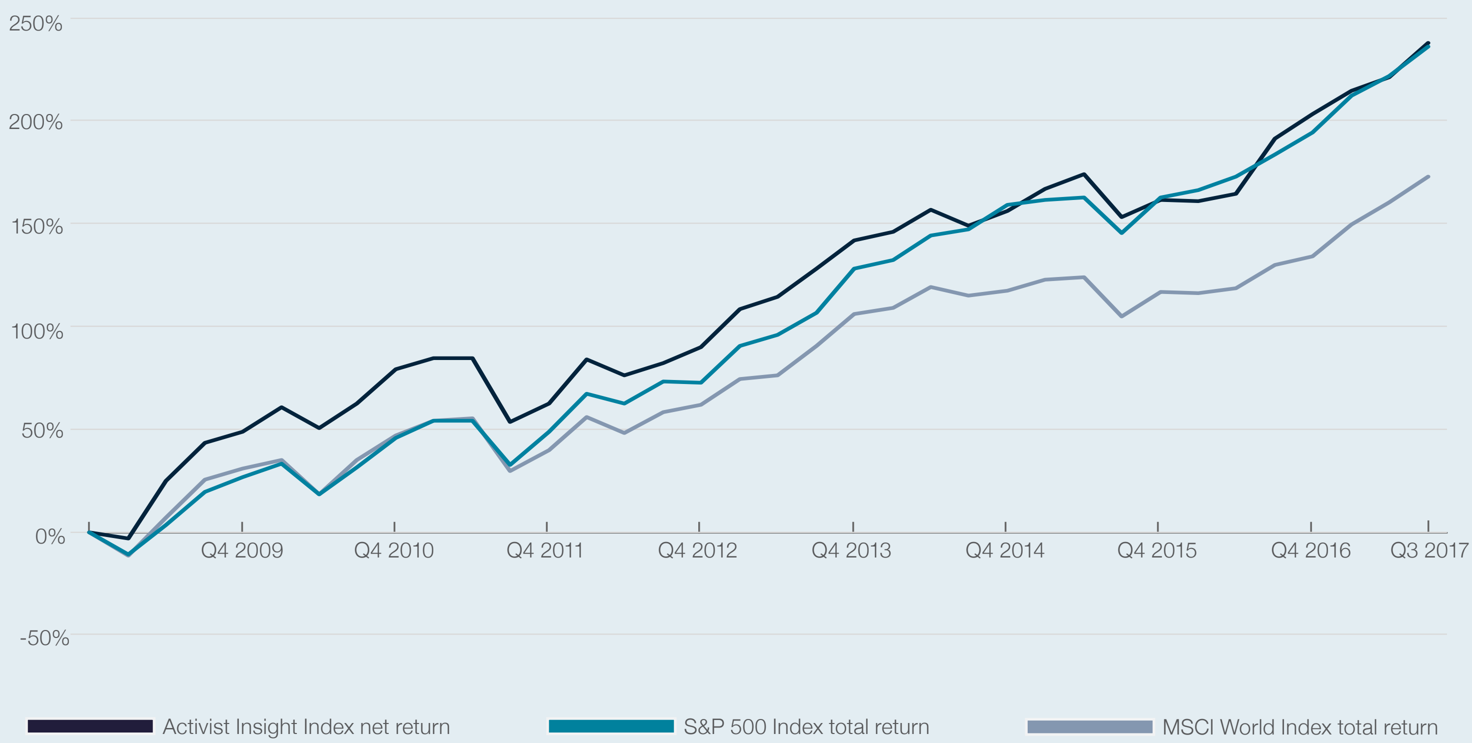
generating companies that have not performed well in the past year. “Retail is a very volatile industry that doesn’t have the characteristics of downside protection,” said Marcos Veremis, a managing director at Cambridge Associates, an investment firm that uses activist strategies selectively in managing institutional portfolios.

Predictions for the new year

With the new U.S. tax bill enacted, 2018 may see market-moving changes resulting from a tax holiday on overseas cash. However, despite the looming amendments, analysts are still confident that activists will perform well in the new year with a continued transitional focus on capital allocation, operational demands, and environmental, social, and governance (ESG) issues. “All signs point to a market that has less upside potential and if that’s the case then operational differentiation is the key, and that’s the direction I think activism is headed,” said Ali Dibadj, a partner at investment management and research firm AllianceBernstein.

In addition, analysts predict an increase in the amount of collaborative engagement between activists and management teams, as recently demonstrated by Alexion Pharmaceuticals and Elliott Management working together to identify a new director to join the company’s board. “More active managers will engage much more diligently and robustly with management teams,” Dibadj said, explaining that activists will need to understand the way the company is run in order to make a real difference. “I think the future of activism is adding value to management teams,” he continued. “Just shaking the trees doesn’t really get you far in activism. You have to really understand the root system of the tree to help management.” For those activists that don’t change their tactics, Veremis warned success will most likely only come if value dominates the 2018 market.

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



REVIVAL AND REACTION

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

Why was there so much attention on large caps this year?

Marc Weingarten: There was a bit of a shakeout in the activist sector a couple of years ago, with poor returns and withdrawal requests, but the survivors of that shakeout were mostly the major activist funds. They've come back pretty strong and have even raised more capital. For them to move the needle on their returns, they need to be going after big game. And I think that's what you saw this year. I think it's the nature of the major players that is responsible for the revival of large-cap activism.

Why were activists apparently so much less successful this year?

Ele Klein: I don't think they have been less successful. The impression comes from a relatively small sample size. Of course, companies today are generally more thoughtful and better prepared for activists, but they also seem to be willing to fight more. Certain advisers appear to be pushing more for fights than in the past. But don't lose sight of some of the fantastic victories on the activist side as well.

MW: In the old days there were plenty of chronic underperformers also guilty of bad governance, and those were really pretty easy plays for the activists. I think there are simply fewer of those around these days, which is why I think activism has turned more operational as opposed to balance sheet [focused]. I think some activists even said that this is why they are more active or are looking outside the U.S. The stock market's at an all-time high, which takes a lot of targets out of play. And I think there are simply fewer egregious cases around, which makes winning chancier.

Do you expect to see a dip in activity next year?

MW: This should be the time of the year when activists are submitting their advanced notifications for the annual meetings next May and June, and I'm seeing fewer of them so far in this period.

EK: While that's right, I think it is too early to really say as we are starting to see a ramp up in activity already. We're now engaged year-round and are definitely gearing up for more nominations.

What do activists think about when they go after a CEO specifically? What do you think about calls for a separate standard from Institutional Shareholder Services (ISS) when a CEO is targeted for removal?

EK: I've said it before that I don't think there's a legitimate issue with ISS. To think that ISS was not and isn't continuing to hold dissidents to a higher standard when targeting CEOs is ridiculous. Of course, ISS is requiring you to support any campaign, and particularly when you want more than one or two seats, you must have a compelling justification. And if you want a majority, you better be able to explain why that's the right answer.

As far as targeting a CEO, I think it is to be expected that if a company is having operational issues you may talk about the CEO. But many campaigns are not specifically targeting the CEOs ultimately. What tends to happen is it becomes very personal. Frequently, the CEO ends up putting his or her reputation on the line by spending so much money to keep a shareholder out of the boardroom.

“When you want more than one or two seats, you must have a compelling justification. And if you want a majority, you better be able to explain why that’s the right answer.”

MW: It’s always an interesting dynamic. Why does an activist target a CEO, as opposed to the board that is supposed to oversee the CEO? Presumably because the activist believes it’s the CEO who is responsible for the poor performance and maybe a misguided strategic direction. Maybe the CEO is really an empire builder doing serial acquisitions, all of which fail. That is probably something that can’t be fixed by just getting a couple of board seats. You either have to go for a majority of the board to really change strategic direction or insist that the CEO be replaced by somebody who has quite a different operational philosophy.

What was the most egregious entrenchment device tactic you saw last year?

EK: What SandRidge Energy did is the obvious one. While Delaware courts have been accepting of pills, particularly short-term pills, one that is adopted with no takeover threat to chill shareholder communication smacks of pure entrenchment. This is a type of pill a court should have issue with because there’s no legitimate reason for a pill here. No one has made a bid on the company. It’s purely to chill shareholders from buying stock to challenge the board, which is not what a pill is supposed to be about. Additionally, the acting in concert definition just smacks of entrenchment.

Given Jana and CalSTRS’ campaign at Apple, can we expect to see more hedge funds seeking environmental or social changes as part of their investments?

EK: ESG initiatives are not a totally new phenomenon as a number of funds, such as Blue Harbour, have been stressing these points in recent years. Both investors in funds and managers of funds have recognized the value proposition as well as the market and societal benefits to looking closely at ESG factors. We would expect this to be a continuing theme in the investment community going forward.

Things are finally starting to happen in Washington, D.C. Is it as bad for activism as it once looked?

MW: Overall there hasn’t been a lot of anti-activist regulatory action in the year since Trump’s been president. He seems awfully disposed to be favorable to Wall Street in general, and activists are participants in that community. The Securities and Exchange Commission (SEC) hasn’t come out with any anti-activist pronouncements or rulings so that doesn’t look so bad. So far, so good, I would say.

An interview with Aneliya Crawford, New York-based partner in Schulte Roth & Zabel’s global Shareholder Activism Group.

In contests with large retail shareholdings, how do you run the fight differently?

Aneliya Crawford: The strategy in retail-heavy shareholder bases is very different. Disciplined and easy-to-understand messaging is key. For example, Trian was incredible at staying focused on the key issues in the Procter & Gamble campaign and not trying to go blow by blow with one of the largest marketing machines in corporate America. Procter & Gamble, on the other hand, drowned its shareholders with communications and this backfired with many retail investors getting frustrated by the daily propaganda and instead asking themselves, how much is this costing us and for what?

Should the proxy voting system be modernized?

AC: Yes, the proxy voting system is in dire need of reform. Unfortunately, I don’t think we will see a reform materialize any time soon. The layers of depositories and intermediaries for beneficial ownership may be a necessary evil but in contested situations often mean that the will of the decision-makers can be lost. Our system currently fails to ensure the integrity of the shareholder vote and without it, shareholder democracy for public companies suffers.

GOVERNMENTS AND GOVERNANCE

Corporate governance is a modern preoccupation of politics around the world, with legislation and regulations influencing where and how activists will target companies in 2018.

From the U.S. to Japan, governments and regulators have introduced, amended, and modified important legal frameworks in 2017, altering the playing field for shareholder activists in the year to come. As the U.S. government leans toward more issuer-friendly policies, investors and proxy advisory firms may become tougher on corporations and their boards. In Europe, protectionism appears to be on the rise, while in Japan and South Korea, governments are taking the fight to businesses.

North America

The November 2016 U.S. presidential election piqued the concern of several activist investors who were unsure whether they had a defender in government following Donald Trump's scathing criticism of hedge fund managers. After Trump appointed veteran activist investor Carl Icahn as his regulatory adviser, however, activists began to think they may have an ally in the new administration (Icahn has since resigned the role amid investigations into his influence on energy policies that impact his investments).

In fact, Trump's influence on shareholder activism is still unclear. Witness the December 2017 tax reform. On the one hand, the reform allows for a one-time repatriation of overseas profits at lower rates, providing shareholders with an opportunity to ask whether that capital will be used to fund investments, M&A, or share buybacks. In contrast, some activists may be forced to pay higher rates on carried interest after 2018, following Congress' decision to lengthen the duration investments must be held to qualify from one to three years.

In addition, the Republican-sponsored Financial CHOICE Act would require registration and greater disclosure from proxy advisers, and remove the right to file shareholder proposals from investors holding less than 1% of a company's stock. "They seem to want to cut off any dialogue between shareholders and companies and I think that would be a very dangerous thing," said James McRitchie, a frequent filer of proposals. "Shareholders are getting further and further away from feeling like shareholders."

Meanwhile, the U.S. Securities and Exchange Commission (SEC) updated its legal bulletin with "issuer-friendly" modifications including amendments that create higher thresholds for shareholder proposals, such as updates to the "ordinary business" exemption, the "economic relevance" exception, and the "proposal by proxy" process. Yet while these changes may hurt some activists, TheCorporateCounsel.net's editor, Broc Romanek thinks most will not be affected. "Shareholder proposals are just one tool in the arsenal of activists – and they are far from being dead," he said.

The Financial CHOICE Act, which passed in the House and stalled in the Senate, would also prohibit the SEC from mandating a universal proxy card, which the agency has added to its "long-term" agenda. That would be something of a blow for activists, who have mostly had requests to use it in individual fights refused.

"The use of a universal proxy card helps to preserve a level playing field allowing stockholders to vote for the candidates they believe are most qualified, regardless of whether they are nominated by the company," Bill Ackman wrote in September. "It is incumbent upon all investors to insist that all companies use a universal proxy card in each shareholder election to make sure that shareholders can easily select the directors they wish to represent them," he said two months later.

The most significant policy changes from leading proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis concern board gender diversity. ISS will consider gender pay gap shareholder proposals and Glass Lewis will recommend against nominating committee chairs if companies don't have at least one female director starting in 2019.

Glass Lewis' senior vice president of research and engagement, Aaron Bertinetti, said he thinks this change

> "What we've seen over the last few years is more focus by activists to target the things that other investors care about that link back to long-term performance."

“The EU’s Shareholder Rights Directive aims to strengthen transparent and active shareholder engagement.”

will encourage activists to target companies that lack a female presence and nominate more female directors to boards. “Gender diversity isn’t just a social issue – it’s an economic and investment issue and that’s what changed,” Bertinetti said, adding that large institutional investors care about diversity. “What we’ve seen over the last few years is more focus by activists to target the things that other investors care about that link back to long-term performance.”

Furthermore, Glass Lewis also decreased its board responsiveness trigger, stating that companies must respond to proposals that receive 20% opposition, down from 25%. “It’s getting back to the fact that the board is the one representing shareholders, the owners of the company, and the members of the board are responsible for that,” Bertinetti said. For ISS, another key change regards poison pills, with the firm recommending against directors of companies that implement a poison pill lasting more than one year without shareholder approval.

Europe

Across the Atlantic, the European Union revised its Shareholder Rights Directive, which must be implemented by member states by mid-2019. The Directive aims to strengthen transparent and active shareholder engagement with changes linked to “say on pay” votes and related-party transactions, among other things.

Among countries that bore the brunt of activism in 2017, the Dutch coalition government led by Prime Minister Mark Rutte is strengthening legal defenses for companies facing activist investors following Elliott Management’s campaign at Dutch chemicals giant AkzoNobel. Under the proposals, Dutch companies would benefit from a cooling-off period of up to 250 days after they receive a request for a “fundamental change of strategy,” which may include takeover bids and activist demands. In addition, the ownership reporting threshold for shareholders in companies with market capitalizations of $750 million and up could be lowered to 1%, from 3% currently.

In general, the U.K.’s legal, regulatory, and political climate remains supportive of shareholder engagement. Brexit’s influence on activist investing is largely unknown, with larger businesses potentially being more exposed to disruption and trade barriers.

So far, activism in the U.K. has accelerated since the referendum, suggesting that it is a short-term spur to activity. Changes to the U.K. Corporate Governance Code in December recognized the importance of diversity on corporate culture and boards and stated that chairmen should resign after nine years. However, Prime Minister Theresa May’s government scaled back suggestions, such as adopting Australia’s “two-strikes” response to failed remuneration proposals and placing worker representatives on boards, which could have been a mixed-bag for activists.

Rest of world

Meanwhile in Asia, Japan remained at the forefront of activism, largely due to changes made by Prime Minister Shinzō Abe. The country’s Stewardship Code, which was adopted in 2014 and modified in 2017, demands that institutional investors engage with their portfolio companies and now requires that asset managers address possible conflicts of interest and provide more transparency on how they vote – potentially opening a gateway for activists. Nonetheless, barriers that prevent cooperation among shareholders – including a vague law that fails to clearly differentiate between insider trading and collective engagement – continue to mar the landscape for activists.

South Korea’s Moon Jae-in, elected president in 2017 after his predecessor was toppled by a scandal stemming from Samsung’s response to an Elliott Management campaign, is expected to push institutional shareholders to adopt the country’s voluntary 2016 Stewardship Code. Moon is also expected to rein in chaebols – large conglomerates controlled by South Korean families – following the arrest of Lee Jae-yong, Samsung’s heir and vice chairman, in the same corruption scandal exposed by Elliott. Yet with companies obliged to give only two weeks advanced notice of shareholder meetings, some refusing to provide share registers to dissidents, and almost all annual meetings in South Korea held during the last week in March, logistical problems for activists remain.

OUTBOUND ACTIVISM

In line with the global trend, activism outside the U.S. retreated slightly in 2017, though some regions were much livelier than in previous years. While activists advanced fewer demands this year on aggregate, their targets were bigger, with large-cap campaigns more frequent across the board.

Europe

Activists publicly targeted 135 European companies in 2017, representing a 5% decrease on 2016, according to *Activist Insight Online* data. While the U.K. market was again the strongest, activity declined by 16%, with 36 issuers falling prey to activists. Activism in Germany, meanwhile, reached record highs with 19 companies publicly subjected to activist demands, beating the previous record of 17 set in 2016.

Activists have increasingly targeted bigger companies in Europe, with Dan Loeb's Third Point Partners taking on Swiss-based Nestlé and Elliott Management pushing the Netherlands' AkzoNobel to merge with U.S. peer PPG Industries. Mid- and large-cap companies represented 44% of all companies targeted in 2017, compared to 37% in 2016 and 39% in 2015.

"Valuations are more reasonable in Europe and activists are attracted to the large global companies there because the business models are comparable to U.S. peers," according to Jim Rossman, head of shareholder advisory at Lazard. "Stichtings, stakeholder issues are viewed as just another hurdle activists have to get over. If they can talk to 19 out of 20 shareholders and convince them, they think they can get CEOs to change course."

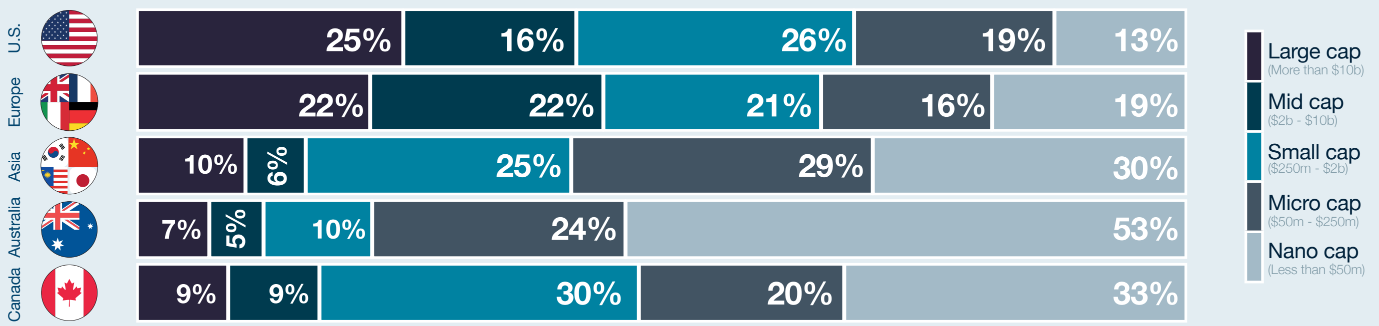
U.K. activist Gatemore Capital, which focuses on the small-cap market, believes Brexit will likely continue to create uncertainty and "plunge additional companies into distress," thus generating openings. However, with the bull market in its ninth year, Gatemore is on the lookout for a correction and is likely to deploy more capital following the next downturn, Managing Partner Liad Meidar told Activist Insight.

Asia

Asian activism broadly underwhelmed this year, with 87 Asian companies subjected to public activist demands in 2017, compared to 90 in 2016. However, Japan bucked this trend with activists targeting 28 issuers, 40% more than in 2016.

Oasis Management – which targeted five Asian companies in 2017, including four in Japan – sees the trend continuing in 2018, as corporate governance and compliance standards become more familiar to public company employees and investors. "Japanese companies are now faced with publicly-understood targets of higher return-on-equity, higher capital efficiency, and much greater levels of transparency for shareholders," Oasis Chief Investment Officer Seth Fischer told Activist Insight. "We believe that this is an extraordinary opportunity for engagement investors."

Activist targets by company headquarters and market cap



Market cap breakdown of companies publicly subjected to activist demands in 2017 by company headquarters. Note: rounding may lead to summation errors.

“The trend in Germany and in other European countries is toward more shareholder activism in the coming years, particularly as U.S. activists become more acquainted with the ‘softly-softly’ approach.”

A generational change at many Asian companies will lead to higher activism levels in the years to come, according to Quarz Capital’s head of research Havard Chi. “The new generation of majority shareholders are more open-minded in implementing proposals which can unlock and enhance the value of their companies,” Chi, who targeted two Singapore-based companies in 2017, told Activist Insight.

“Shareholders globally are more vocal about their concerns on governance as well as financial performance of the companies in which they invest.”

Singapore has been undergoing a privatization process in recent years and Quarz sees “enormous opportunities” to close valuation gaps, while Oasis is excited about an overhaul of South Korea’s corporate governance code and improved shareholder rights. Momentum is growing in South Korea but lags behind Japan’s, Asset Value Investors’ Daniel Lee told Activist Insight, arguing that the Korean government is only trying to suppress abuse by chaebols. Whatever the trend, Elliott Management has had a more constructive dialog with Samsung Electronics, a departure from the contentious battle around Samsung’s consolidation efforts in 2015.

Australia, New Zealand, and Africa

Activism in these regions dropped in 2017 but remained at elevated levels. In Australia and New Zealand, 60 companies were targeted in 2017 compared to 65 in the previous year and 59 in 2015. Activity was driven primarily by occasional activists and concerned shareholders, although Elliott Management generated most headlines with its ongoing campaign at Australia’s national champion, BHP.

In Africa, ten companies were publicly subjected to activist demands, with most of the campaigns taking place in South Africa. The eruption of the Steinhoff International accounting

Activist targets by company headquarters

Number of companies publicly subjected to activist demands in 2016 and 2017 by company headquarters.

“Shareholders globally are more vocal about their concerns on governance as well as the financial performance of the companies in which they invest.”

scandal at the end of 2017 may boost shareholder activism in the coming years, as investors become frustrated with the lack of accountability in boardrooms.

Canada

Activism in Canada continued its decline in 2017, with 47 companies targeted compared to 53 in 2016 and 60 in 2015. With two-thirds of the country’s stock listings operating in the energy and financial sectors, activism in the country is correlated with the state of these industries.

“In many cases, energy and material companies have only recently emerged from a multi-year cyclical downturn. Cyclical dynamics have had a modest dampening effect on both activist and capital markets activity,” Zach George, a founding partner of FrontFour Capital, told Activist Insight. Activists targeted 15 basic materials companies in 2017 against 20 in 2016 and 24 in 2015. In addition to FrontFour, U.S. activists Land and Buildings and Sarissa Capital launched campaigns north of the border. Newly-minted activists were also active, with Delbrook Capital and PointNorth Capital winning proxy contests at Rapier Gold and Liquor Stores, respectively.

Outlook

As U.S. activists face fewer opportunities at home, the exodus to Europe and Asia may continue given the presence of trading discounts, the shifting shareholder structure from founders to index funds, and cultural adaptation. Home-grown activism, although still at an incipient stage in most regions, is expected to increase, particularly as legal frameworks become more shareholder-friendly.

“Shareholders globally are more vocal about their concerns on governance as well as the financial performance of the companies in which they invest,” Morrow Sodali director Fabio Bianconi told Activist Insight. “The willingness for domestic investors to deploy activist strategies is not considered taboo anymore.”

EUROPEAN SNAPSHOT

An interview with Jim McNally, London-based partner in Schulte Roth & Zabel’s global Shareholder Activism Group.

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Does it feel like a lot of the bigger activists have migrated to Continental Europe?

Jim McNally: The big activists are certainly aware of opportunities on the Continent. The caution of going into the unknown has receded as the unknown has become the known. The larger players have tooled up and are better equipped to understand how to navigate the different legal and cultural systems. There are also uncertainties in the U.K., of which Brexit is one. Some businesses are more exposed to Brexit risks than others and there is an opportunity there to help them navigate those challenges, whether it be through M&A or operational choices. But management teams are finding it hard to make decisions – there is a long list of questions to be worked through, and some of those will be without clear answers for some time yet.

What have been the notable changes in European activism this year?

JM: It’s been a common theme that activists have needed to show there’s more to the “softly-softly” approach. That’s often still the best way to open with, but boards may have misunderstood that to mean an activist won’t push the matter any further. If issuers are open to working with activists, they can get quite a lot out of it - it can be quite a rewarding relationship once everyone is aligned.

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THE REAL COST OF A PROXY FIGHT

Companies and activists should beware the hidden costs of taking their arguments to the ballot box. By Cas Sydorowitz, CEO corporate advisory, Georgeson EMEA.

Among the many lessons learnt from activist campaigns in 2017, perhaps the most important related to the costs – both literal and hidden – of a proxy contest. Such fights were highly visible this past year, due to the size of the companies and the intensity with which they were waged. After several years of more frequent settlements, the pendulum may be swinging back to fights. Yet both activists and issuers should consider the full range of consequences before deciding to follow this trend.

The most widely followed contest in 2017 was Trian Partners' quest for a board seat at Procter & Gamble (P&G) – not only the largest company ever to partake in a solicitation of this kind but the most expensive fight of all time. Trian Partners itself spent as much as $25 million (on top of its more than $3 billion investment), while P&G is believed to have spent over $100 million in total. These figures include not only the direct cost of chasing votes – but also the legions of bankers and consultants.

While an obvious outlier, P&G is not as far from the average as you might expect. According to Activist Insight data taken from 2015-2017 proxy statements, the average anticipated spend on solicitation alone in a contest at an issuer with a market cap of $10 billion and higher is $7 million for activists and $14 million for issuers.

Against the outcome of the P&G fight – where the company was declared the technical winner after two recounts by just a few thousand votes – this seems gratuitous. When 49% of shareholders support the dissident, it is near impossible for a company to declare victory. Adding someone to the board is not as grievous as many issuers think, especially when the board can be expanded, given the cost and time invested in waging a proxy fight.

Then there are the hidden, or unquantifiable costs to these fights. Once in solicitation mode, a management team's time is invariably consumed by strategizing, responding to criticisms levelled both publicly and in private meetings with shareholders, and travelling to meet as many investors as possible. Even where a company's strategy is clear, management will be required to defend it with "20:20" clarity. Scrutiny by analysts and the media – often with imperfect information – will intensify. Where changes to a board, operations, or capital structure have been planned and must be brought forward, an activist's involvement will likely make each more expensive.

For an activist, there is also more on the line than its reputation. Losing a proxy contest can harm an activist's ability to recruit quality candidates, negotiate with management teams, and retain its capital. Moreover, launching a proxy fight at the wrong time can impede value-creation by deterring potential buyers or accelerating turnover at the issuer.

> "Adding someone to the board is not as grievous as many issuers think, especially when the board can be expanded."

With all this in mind, when does it make sense to fight an activist, rather than negotiating with it? An activist will often take this step only when it feels it can win, so any assessment must start with who has most to lose by accepting some or all of the activist's demands. While the board may not welcome a self-nominated activist, consider that it has invested significant capital, and will know as much about the company, if not more, as incumbent board members. Embracing an activist-nominated candidate is worthy of consideration despite who is promoting them, as many other investors may be sympathetic.

One of the most important tools to have at hand during a proxy fight is a fully charged battery pack to keep your phone running at any time during the day and night. Keep your toothbrush in your desk because you never know when you will be required to stay late.

BOARD SEAT BLUES

Excepting a narrow victory for Trian Partners at Procter & Gamble, activists found their paths to board seats tougher in both proxy contests and settlement talks in 2017.

Far more than in previous years, activism in 2017 was defined by the ballot box. Not only did the number of proxy contests that went to a vote exceed 2016's recent peak of 25 by one, but the number of large companies engaged in proxy fights and their outcomes provoked a reckoning for some of the best-known activists. Defeats for Pershing Square Capital Management at Automatic Data Processing (ADP) and Greenlight Capital at General Motors cast a pall over large activists until Trian Partners was offered a board seat at Procter & Gamble (P&G) – in order to forestall a protracted dispute – following two recounts.

As with overall levels of activism, the number of public requests for board representation in the U.S. fell in 2017. There, 183 companies faced such demands, down from 245 the year previously. That could reflect more resistance behind the scenes, since successful campaigns are more likely to become public.

Settlement fatigue

Indeed, though caution is often urged when drawing conclusions from highly idiosyncratic campaigns, the theme of 2017 appears to be a greater willingness on the part of issuers to play hardball in defense, perhaps due to disenchantment with the experience of management teams who settled in previous years, according to some advisers.

Settlements without at least a public show of resistance by management fell by three percentage points in the U.S., while the proportion of demands going to a vote was its highest since 2014. 21% of U.S. board seat campaigns settled once boards said they would not add the activist nominees, down from 33% in 2016 and as high as 37% in 2014.

Indeed, 2014 provided a useful comparison for the standing of activists, combining a relatively benign economic backdrop with appetite on the part of large activists for ambitious conquests. Then, 24% of resisted board seat demands were at companies with a market cap of more than $2 billion, versus 23% in 2017.

In 2014 as in 2017, four activist demands for board seats at large-cap companies ($10 billion and up) appeared to be heading for a shareholder vote. Yet while in 2014 Dow Chemical and eBay settled with their tormentors and Allergan found a white knight to deliver it from a special meeting, Arconic was the only one of four large cap targets in 2017 to settle, and even then, only on the eve of the vote following the firing of its CEO as Elliott Management had demanded.

> "With the decline in settlements, board seats have been harder to come by."

Lower yields

With the decline in settlements, board seats have been harder to come by. Activists gained seats in 54% of proxy fights in 2017 – a slight improvement on 2016 thanks to P&G's about turn (which Activist Insight counts for Trian), but well below the 63% they managed in 2014. And although the number of seats won in 2017 – 34 – was slightly above par for 2015 or 2016, it was well below 2014's haul of 66. The average number of seats won in settlements – 1.6 – was also below 2014's 1.7.

"Institutions are pushing back against settlements and saying, why settle with this activist when your board may need more industry experience or gender or racial diversity," Steve Barg, co-head of Goldman Sach's M&A Group, told Activist Insight in an interview. "It's less about, 'What's the harm?' and more, 'What's the benefit?'"

Yet as an explanation for activists' growing misfortune the increasing influence of index funds is hard to discern from the data. Records kept by Proxy Insight, Activist Insight's sister company, appear to indicate a resurgence of support for activists. BlackRock, which earned headlines a few years ago by apparently warning CEOs off settlements, voted on dissident cards in one-third of Russell 3000 Index contests in 2017 – its highest level since 2014 – including at ADP and P&G. Vanguard, long seen as the most hostile to activists, voted on the dissident card in 50% of fights in the first six months of the year (that level was likely to fall, as its votes at ADP, P&G, and Deckers were not available at the time of going to print, but it is believed to have supported management in all three).

> “While incumbents with strong financial performance appear to have a better hand than in prior years, 2017 provided no guarantee of invincibility.”

Settle for less

A simpler answer, however, might be the declining quality of opportunities available to activists. After growing rapidly for years, activism has left few unprepared or systematically weak companies – especially among large caps in a rising market.

Coupled with overreach, most clearly shown in the full slate contest at Deckers, where Marcato Capital Management cut its slate by two-thirds a week before the meeting and still fell just short, the pressure to settle for fewer board seats may have a profound impact on activism in the years to come. It may lead to an increase in demands for special board committees and CEO change, seeking control by “stealth,” according to Derek Zaba of CamberView Partners.

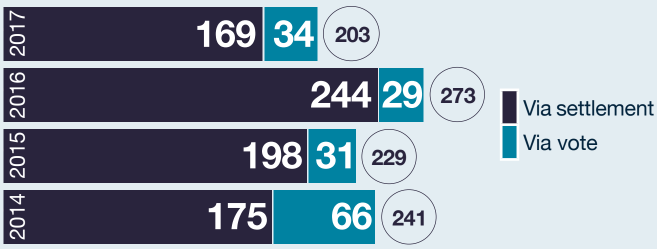
Indeed, the performance of CEOs created binary strategies in 2017’s proxy fights. At P&G and General Motors, activists sought to deweaponize the issue by insisting they supported David Taylor and Mary Barra, respectively. At Buffalo Wild Wings and Arconic, meanwhile, attacking the occupants of the corner office became central to the activist’s message.

And while incumbents with strong financial performance appear to have a better hand than in prior years, 2017 provided no guarantee of invincibility. Boards increasingly must consider their records not just as a unit, but as a collection of individuals with diverse skills and identities. Activists can call not only on better nominees, but executives willing to be put forward as replacement CEOs. Resistance may not be futile but long, expensive proxy fights do not always provide the satisfaction ADP CEO Carlos Rodriguez hinted at when celebrating what he described as an “ass-whipping” for Bill Ackman’s fund.

Settlement times

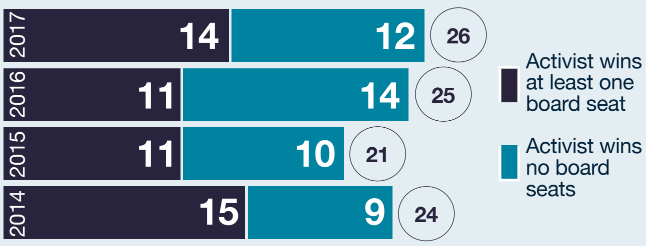
Average number of days from an activist’s announcement of its intention to seek board representation until settlement at U.S.-headquartered companies by year.

Board seats gained



Total number of board seats gained by activists at U.S.-headquartered companies via means of settlement or shareholder vote.

Proxy contest vote outcomes



Total number of proxy contests that went to a vote at U.S.-headquartered companies and eventual outcome.

Buffalo Wild Wings, P&G, Rent-A-Center, and Cypress Semiconductor all faced proxy contests in 2017.

THE LEGAL ANALYSIS

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An interview with Michael Swartz, co-chair of Schulte Roth & Zabel's Litigation Group and partner heading shareholder activism litigation.

What have you seen companies doing in 2017?

While companies of all sizes seem more willing to fight, we have particularly seen an uptick in aggressive defensive tactics taken by boards of small- and mid-cap issuers seeking to entrench themselves. We seldom see issuers bringing 13D [disclosure] suits anymore because the proxy advisory firms and other shareholders tend to react negatively to issuers suing their shareholders, but we did see one such suit this year, so the old playbook is being dusted off when needed.

Perhaps the most interesting situation we were involved in during 2017 relating to board entrenchment was at Immunomedics, a bio-pharma company, where the incumbent board was clearly losing its proxy contest to venBio, which was seeking a majority of Immunomedics' board seats.

One week before the annual meeting, the incumbent board adjourned the meeting for two weeks, changed the company's bylaws from a majority to a plurality vote standard, announced its entry into a worldwide licensing agreement for the company's only viable drug, and argued that the incumbent board should be left in place to manage the deal. Remarkably, the company's banker was doubly conflicted. The company agreed to pay the banker a success fee both for its entering into a licensing agreement and for the company winning the proxy contest; the banker also gave a fairness opinion in support of the licensing deal. We brought suit in Delaware Chancery Court, arguing that the deal was rushed, well below market [value], and constituted a blatant act of entrenchment. We won.

Among other things, the court granted our motion for a temporary restraining order [TRO] preventing the licensing transaction from closing and, following discovery, the deal was abandoned. This case marked the first time that a major corporate deal was unwound in the context of a proxy contest on the basis that it was an entrenchment device. The even better ending to this story is that venBio won the proxy contest, and Immunomedics' stock price has quintupled from the time that venBio announced that it would nominate directors through the end of 2017.

Did any other lawsuits strike you as important?

Yes. In connection with the proxy contest at Innoviva, the Delaware Chancery Court held that an oral agreement with Sarissa Capital Management to expand the size of the board and appoint two of Sarissa's nominees was enforceable. There, a director of Innoviva and an officer of Sarissa agreed that they "had a deal" to settle the proxy contest and that their respective teams would prepare the "paperwork." Subsequently, before signing the settlement agreement, Innoviva learned that another major stockholder had voted in favor of the incumbent slate, effectively ensuring the board's re-election, and called off the settlement. Sarissa then sued. The court agreed with Sarissa that the parties had reached an unconditional oral settlement agreement, and granted Sarissa specific performance.

The decision serves as a cautionary tale that issuers and activists alike need to exercise extreme care in discussing settlement and pay particular attention to whether an oral agreement is conditioned on signing a written instrument.

Where do you see any new issues for litigation developing in the future?

One of the issues that emerged this year has to do with the counting of votes held in street name during contested elections. Voting technicalities have long been an issue in appraisal cases, where stock ownership and whether that stock has been voted in favor of an M&A transaction needs to be traced in order to determine shareholder standing to sue.

More recently, voting mechanics have become an issue in contested elections. In the future, activists should pay particular attention to make sure that stockholder votes in street name correspond to the issuer's stockholder list, including the DTC omnibus proxy and respondent proxy lists. For example, votes made through intermediaries like Broadridge do not always correspond with a company's stockholder list, and therefore may not be counted by the inspector of elections. This could make the difference between winning and losing a contested election.

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WINNING THE GROUND GAME

The importance of effective shareholder communications and market intelligence in a proxy fight. An article by Bob Marese, Paul Schulman, and Dave Whissel from MacKenzie Partners.

Effective retail shareholder outreach is a critical component of any proxy contest, but the importance of these investors was magnified in several proxy contests in 2017. While media outlets often focus on the recommendations of the proxy advisory firms and the voting patterns of the large index funds as being determinative of the outcome of proxy fights, the retail component can and frequently does make the difference in tight campaigns.

Retail solicitation is perhaps the less glamorous side of the proxy solicitation business, but is no less important. It generally requires a sustained and coordinated old-fashioned telephone calling campaign and frequent physical mailings to overcome retail investors' rational apathy. Callers must be prepared to deal with rejection and criticism. Or, more often, in the age of almost universal caller ID, their calls will simply go unanswered. Fight letters that were painstakingly crafted are often tossed in the trash without a second thought.

Additionally, the retail votes tend to trickle in over the course of the solicitation period, rather than all at once following a specific milestone such as a proxy advisory firm recommendation, so there is less "drama" surrounding the outcome of the retail vote and few last-minute switches that can turn the tide of the contest. Over time, however, that vote accumulates, and if the company is able to prompt retail investors to take action, they can often count on reasonably high levels of support.

That was largely the case at Procter & Gamble (P&G), which was involved in a proxy contest against Trian Fund Management last year, where a large portion of the company's retail holders voted on management's blue proxy card. And in contrast to what is the case with most other large companies, which are primarily institutionally held, that retail vote may have ultimately carried the day.

> "Retail solicitation is perhaps the less glamorous side of the proxy solicitation business, but is no less important."

But P&G's strong retail support was not simply the result of shareholders voting reflexively for management; reaching these voters required a coordinated team effort, from financial, public relations, and legal advisors, to the company's outstanding in-house investor relations, communications, and legal teams.

The company began its campaign early, and the numerous mailings to its vast shareholder base were effective in drawing attention to the importance of this particular vote and the issues at stake to many holders who would not normally have voted. For retail shareholders, carefully crafted, impactful communications can help sway undecided voters, but the timing of the mailings can also be a decisive factor. It is important to get your proxy card in front of these holders early and often such that, ideally, your card is the first and last one that they receive.

Likewise, social media – which is quickly becoming a critical shareholder communications platform – provides ample opportunities for companies to get their message across to a large number of retail voters in a targeted and cost-effective fashion. For example, for companies that are part of the fabric of their local communities, it can be helpful to craft a localized social media campaign to reach the employee and retiree bases, which can be substantial. More creative efforts, like billboards and newspaper advertisements may also be used.

Just as important during a campaign is the identification of the company's shareholders and the tracking of their votes. Market intelligence is another often overlooked component of proxy contests, but is likewise critical to success – often in unexpected ways. For example, we have seen a last-minute settlement during a fight because one of the parties had incorrectly identified the vote of a key shareholder. Accurately identifying shareholder votes as they come in is the only way to truly know where you stand, which enables you to react to new information and new developments on a real-time basis.

When you consider that the bulk of a company like P&G's shares are voted in the span of just a few days before the

“As we look back on the P&G campaign, we do not view it as being necessarily reflective of 2017’s larger activism trends.”

meeting, the challenge of identifying the vote of a small or mid-sized shareholder is apparent. A single custodian could hold millions of shares, making the identification of smaller institutions extremely difficult without a deep understanding of the shareholder base, historical voting patterns at the target company and elsewhere, and where each institution holds its shares. However, by identifying certain key votes promptly, the P&G team was able to understand where its vulnerabilities lie, and where to focus its energy on reaching out to those institutions that were undecided or had voted adversely to management. During a proxy contest, it is always important to know where you stand, and accurate shareholder identification and vote tracking can make that possible.

As we look back on the P&G campaign, we do not view it as being necessarily reflective of 2017’s larger activism trends. Instead, a number of the salient features of the contest – the importance of the retail “ground game,” the significant number of registered holders, the centrality of the company to the local community – were more reminiscent of “old school” campaigns, from which there are many lessons to be learned. The proxy contest at P&G was unique and historic for many reasons, but perhaps chief among those was the tremendous effort that the contest – which was the largest ever by some distance – demanded from the company’s executives, employees, and adviser team. Ultimately, the amount and quality of work put in by companies and their advisory teams during a proxy contest can be the difference between winning and losing, and having adequate support and sound advice is a critical component of the process.

“Ultimately, the amount and quality of work put in by companies and their advisory teams during a proxy contest can be the difference between winning and losing.”

BETTING ON FRAUD

An incessant bull market frustrated activist short sellers in 2017, prompting greater focus on noncyclical stocks, fraud, and accounting irregularities. This year, short sellers are watching valuations and cryptocurrency speculation.

The number of campaigns by activist short sellers dropped dramatically in 2017 as a rising stock market curbed opportunities in the sector. Short sellers launched 185 campaigns last year, representing a 30% decrease on 2016 and 33% on 2015. As in previous years, the U.S. market was the most active by far, with 137 campaigns recorded. China and Hong Kong also attracted interest, with 18 campaigns, while activity in Canada and Japan tumbled by 57% and 80%, respectively. Short sellers launched just nine campaigns in Canada in 2017 due to a lack of opportunities in the basic materials market, which enjoyed a welcome recovery.

Tough calls

In the U.S., a soaring stock market coupled with tailwinds from tax reform and a strong economy put valuation short sellers in difficulty. Indeed, the total of 12 "bubble" allegations represented a five-year low, and a significant reduction from the 30 such allegations recorded in 2016. Meanwhile, allegations of business fraud more than doubled to 21 and represented 11% of all public allegations, versus 3% in 2016 and 2015. Allegations of accounting fraud held steady between 2016 and 2017, despite the overall decline in campaigns.

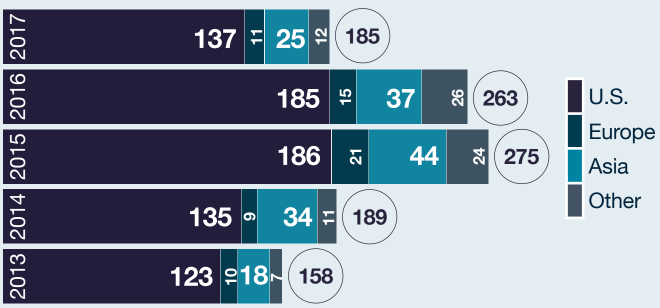
In an interview with Activist Insight, veteran Citron Research short seller Andrew Left admitted that 2017 was "terrible" for short sellers, prompting him to take long positions to reduce risk.

Short sellers have also been struck by outflows, with institutional allocation to short strategies hovering near all-time lows – unsurprising given the smooth bull market. "First and foremost on our agenda is survival and risk management," Gotham City Research's Daniel Yu, who described 2017 as "humbling" and "not bad," told Activist Insight. "I believe that more than half of this business is simply about living to see another day."

Kerrisdale Capital saw the year differently, although the fund is largely specialized in non cyclical biotechnology companies that develop make-or-break products. Kerrisdale's Sahm Adrangi told Activist Insight that 2017 was "a great year for short activism" and that Kerrisdale was able to find compelling targets. The short seller struck gold with campaigns against biotechnology firms Pulse Biosciences and Prothena, but had a rollercoaster year with satellite internet provider ViaSat.

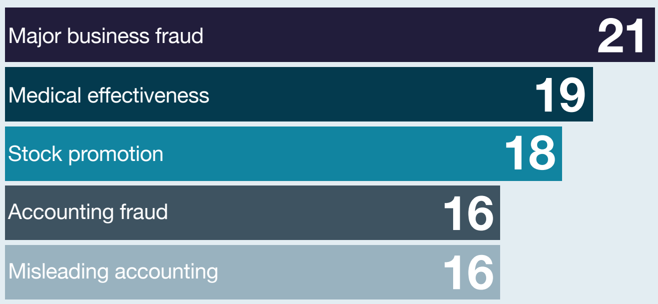
While other short sellers struggled, Viceroy Research had a great year. The short selling outfit, which had already earned a reputation for dogged investigations in the niche world of short selling, came to prominence after publishing an extensive negative report on Steinhoff International hours before the South African company unveiled accounting irregularities that wiped out 90% of the stock's value. In an interview with Activist Insight, Viceroy argued that the bull market "doesn't really affect [its] activity" because its focus is chiefly on frauds. "A rise in accounting based short reports is good for the markets - it encourages better stewardship, keeping management honest and transparent," Viceroy said.

Activist short campaigns by region



Number of activist short selling campaigns launched by year and company headquarters.

Top activist short seller allegations in 2017



Most frequent allegations made by activist short sellers in 2017.

> “Valuation shorts, which have been bad shorts for five years now, will finally mean something and the catalyst behind them will be the tax reform.”

Lured by change

Around half the companies targeted by activist short sellers in 2017 operated in either the technology or healthcare industries – hardly surprising, given that both sectors are constantly evolving. “Emerging sectors and novel industries, where there is a lot of change and uncertainty, are attractive for short sellers as opposed to sectors that people understand, such as consumer staples,” Adrangi said.

In the technology sector, car maker Tesla continued to be an attractive target, despite a climbing stock price, with Kynikos Associates’ Jim Chanos among the most energetic detractors. Meanwhile, a bidding war between Verizon and AT&T for StraightPath Communications – which ended with Verizon paying a 500% premium – proved painful for a host of short sellers, including Kerrisdale, White Diamond Research, and Richard Pearson.

In the healthcare realm, Chanos joined Citron in its 2 year short campaign against Mallinckrodt, agreeing with Left that the firm’s main drug Acthar is overpriced. By the end of the year, MiMedx found itself a short target, with Viceroy Research and Aurelius Value first accusing the company of channel stuffing. Marc Cohodes and Citron later joined the fray.

Downsizing

A notable trend in 2017 saw activist short sellers largely avoid new campaigns at large-cap issuers, in what may be another consequence of the ceaselessly ascending market. Small companies, with a market capitalization below $2 billion, represented 72% of total targets in 2017, compared to 59% in 2016. Just 18 campaigns were launched at companies with a market cap of over $10 billion globally in 2017, representing nearly 10% of the total. In 2016, short sellers were much bolder, with 39 campaigns predicting declines at large-cap stocks, or 15% of all campaigns.

Even so, some researchers continued to rake that corner of the market. Kynikos Associates targeted shale explorer Continental Resources and used car retailer CarMax, although the bets have yet to pay off. Citron was the most active short seller in the large-cap category, publishing negative reports on five companies, including Motorola Solutions, Shopify, and Nvidia.

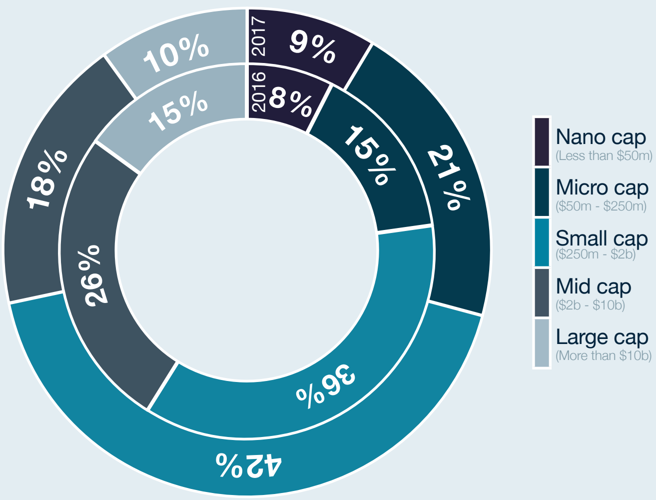
Citron is known to go after targets that are household names, and Left admitted to Activist Insight that he overlooked one of the biggest implosions of the year, Steinhoff, because the company was South African and the allegation underwhelming.

Outlook

In 2018, shorts based on earnings-multiples may stage a comeback, particularly if the bull market runs out of steam. “Valuation shorts, which have been bad shorts for five years now, will finally mean something and the catalyst behind them will be the tax reform,” Left said, contending that profitable companies will see higher earnings and inflows while inflated money-losing firms will be less attractive.

The cryptocurrency space may also present opportunities, although high volatility may deter some short sellers. Citron has already unveiled some hedged bets against the emerging technology, and Adrangi told Activist Insight that Kerrisdale was considering potential shorts. Bubbles of all sorts face a day of reckoning.

Activist short campaigns by market cap



Market cap breakdown of activist short campaigns in 2016 and 2017.

ACTIVIST SHORT SELLER TOP FIVE

Each year, Activist Insight produces a list of the most impactful activist short sellers of the past 12 months, comprehensively derived from the *Activist Insight Shorts* database. Short sellers are ranked by number of campaigns initiated, average one week and total campaign returns*, average size of targeted companies, depth and severity of allegations, company response rate, and news stories written about the activist on *Activist Insight Shorts* in 2017. What follows are Activist Insight's top five short sellers of 2017.

Total campaign return is a calculation of the stock price change percentage, minus any dividend payment obligations, and adjusted for splits, of campaigns initiated in 2017 from the close prior to the campaign's announcement until the last close in 2017.

01 AURELIUS VALUE

Short selling campaigns in 2017	5
Average 2017 total campaign return	8.0%
Location	Unknown
Key individuals	Anonymous

02 VICEROY RESEARCH

Short selling campaigns in 2017	5
Average 2017 total campaign return	44.3%
Location	U.K., Australia
Key individuals	Fraser Perring

2017 was a bumper year for Aurelius Value, an outfit that began publishing anonymous reports just two years ago. Chiefly focusing on frauds, Aurelius' allegations are always painful for its targets, with four of them forced to publicly respond last year. The activist gained prominence after it accused MiMedx Group of channel stuffing in September, hours before Viceroy Research came out with similar allegations. The report inspired Citron Research and the outspoken Marc Cohodes to start their own investigations.

In addition to MiMedx, the short seller targeted PetMed Express, an online pet pharmacy it said was pushing opioids to drug addicts to boost its profits. Market interest dropped, however, when the company placed checks on its advertising and said the sale of opioids was a small part of its business.

With half of its campaigns launched in the banking sector since inception, the activist has established itself as a specialist in financial fraud. Aurelius stirred its biggest controversy in 2016 with a crusade against Banc of California, alleging the bank's executives had ties to a criminal figure. The claims, which essentially put Aurelius on the map, prompted the involvement of activist investor Legion Partners Asset Management and pension fund California State Teachers' Retirement System (CalSTRS). In 2017, the short seller accused Eagle Bancorp executives of lending themselves company money and maintained insurance firm Citizens was a Ponzi scheme.

The end of 2017 was remarkable for Viceroy Research with the short selling outfit becoming the victim of its own success. Viceroy's short report against South Africa's national champion Steinhoff International was so well-timed that founder Fraser Perring discarded his anonymity in the aftermath. Steinhoff revealed accounting irregularities hours before Viceroy published a report alleging wrongdoing, leading to a 90% decline in the stock. This overnight drop propelled Viceroy's average annual return to the highest among short sellers covered by *Activist Insight Shorts*. "We had been developing a thesis over many months. After the collapse, we considered it in the best interest of stakeholders that we publish our findings," Viceroy told Activist Insight.

Before its watershed Steinhoff scandal, Viceroy had already made a name for itself in the short selling community, initiating campaigns against MiMedx and Israeli-based companies NeuroDerm and Caesarstone Sdot-Yam. Its efforts at MiMedx stand out; the activist is so convinced of its thesis that it published 22 negative reports in the three months through December.

2018 promises to be interesting for Viceroy as it faces increased media scrutiny and higher expectations for its reports. The activist said it is working on a number of theses globally, chiefly focused on accounting irregularities. With greater power comes greater responsibility.

03 CITRON RESEARCH

Short selling campaigns in 2017	13
Average 2017 total campaign return	-20.3%
Location	U.S.
Key individuals	Andrew Left

A veteran activist short seller, Citron Research's Andrew Left had a mixed year in 2017, with most of his large-cap campaigns failing to generate the buzz of his defining short, at Valeant Pharmaceuticals in 2015.

In December 2017, Citron dallied with bitcoin shorts, covering its positions early as volatility provided an opportunity to take the "easy money," while making the next move hard to predict.

Although his average campaign return in 2017 was negative 20%, with failing bets against Nvidia, Exact Sciences, and Motorola Solutions, Left said that some long positions provided cushion. "It has been a challenging year, it's humbling, it really is," Left said of the bull market. "I accept the fact that, even if I'm right, the truth is that you have to be moderate and have respect for the market and what you're seeing out there."

In 2018, Left said he would continue to focus on the U.S., although he did not rule out targeting European companies.

04 GOTHAM CITY RESEARCH

Short selling campaigns in 2017	3
Average 2017 total campaign return	8.4%
Location	U.S.
Key individuals	Daniel Yu

Daniel Yu's Gotham City Research largely avoided the U.S. in 2017, venturing into Europe and Hong Kong. The investor, a specialist in uncovering frauds, led a spirited offensive against Germany's Aurelius Equity Opportunities, declaring the private equity firm was cooking its books. To Gotham's chagrin, German regulators did not initiate an investigation even after the company tacitly admitted that it had lied about its CEO's qualifications. "Our experience with Aurelius Equity left a sour taste in our mouth," Yu told Activist Insight.

A crusade against Apple supplier AAC Technologies seemed successful at first, with the stock price tumbling after Gotham claimed the Hong Kong-based firm was overstating its margins. However, as the bull market lifted all Apple suppliers indiscriminately, AAC's stock recovered. "We were right about the margins and wrong on the stock," Yu said.

Gotham's biggest omission in 2017 was its failure to publish a negative report on Steinhoff International, despite planning to do so repeatedly. Yu says he thought that a short on French online advertising company Criteo, which crashed 60% in the aftermath, was timelier than a campaign on Steinhoff.

05 THE STREET SWEEPER

Short selling campaigns in 2017	24
Average 2017 total campaign return	10.9%
Location	U.S.
Key individuals	Sonya Colberg, Melissa Davis

The Street Sweeper, a research outfit headed by Sonya Colberg and Melissa Davis, is known for publishing short but punchy negative reports on small companies. The average market capitalization of its targets is $300 million and it will often zero in on what it alleges are stock promotion schemes.

Partnering with the general public to expose corporate fraud, The Street Sweeper's short reports frequently prompt fellow activists to initiate more thorough investigations. Kerrisdale Capital targeted Pulse Biosciences months after The Street Sweeper warned of stock dilution. Meanwhile, Mako Research claimed Adomani was a fraud and would likely go bankrupt after The Street Sweeper accused the electric car parts supplier of aggressively promoting its stock.

EUROPE SAYS NO TO U.S. PAY

European investors are leading a charge against U.S. compensation practices. Proxy Insight uncovers the effort to bring American firms up to "global standards."

The average level of support for U.S. "say on pay" votes in 2017 was 91.8%, only 0.1% down from 2016. This statistic may look benign, but it hides an alarming development that U.S. companies would do well not to ignore. Research from Proxy Insight previously released in online magazine *Proxy Monthly* shows that many European investors have been voting very aggressively on U.S. "say on pay" votes — much more so than at U.K. companies, which have themselves been under the spotlight lately.

Global standards

Using European investors' "say on pay" votes from the 2016/17 proxy season at both U.S. and U.K. issuers highlights the disparity. Top French asset manager Amundi Asset Management, which has only just started to disclose its proxy voting records, voted against 43% of U.S. "say on pay" resolutions in the year to June 2017 and told Proxy Insight that "U.S. remuneration structures are so 'exotic' that they have required a temporary exception from the global principles of our voting policy."

"If we had applied our usual requirements for serious performance criteria especially in LTIPs [long-term incentive plans], we would have voted against too many "say on pay" [resolutions], so we chose to still support those who were above average or improving, while waiting for U.S. practices to reach global standards," said Cédric Lavérie, the former head of corporate governance at Amundi, who recently left to lead French research at Institutional Shareholder Services (ISS).

Likewise, Paul Lee, head of corporate governance at newly merged Standard Life Aberdeen, did not hold back. "One of my frustrations from a global perspective is we spend a long time talking about pay in the U.K., but the real problem with pay is in North America," he said. In particular, Lee highlighted long-term bonus schemes that see some companies paying out after just one year.

Schroders makes for another noteworthy entry on the list, not typically being known for aggressive voting. On this matter, however, Schroders shares some of the same concerns raised by other asset managers. "We are being more demanding, especially when looking into company performance compared to quantum of pay," Dan Veazey, corporate governance specialist, told Proxy Insight. "Our main reasons for voting against remuneration were a pay for performance disconnect, the vesting period of a plan being less than three years, and a lack of disclosure on performance targets."

Big and tall

Dutch pension fund PGGM, which opposed all but 3.9% of U.S. "say on pay" votes, was less reserved. Rogier Snijdewind, its senior advisor for responsible investment, argued that "executive pay in the U.S. is simply too high and too complex." Snijdewind spoke of how PGGM is "concerned about pay plans in the U.S., in terms of the structure and level of the pay… Remuneration plans are often non-transparent and difficult to understand."

Snijdewind believes option plans "incentivize short-term risk taking," and therefore "don't align executives with long-term shareholders' interests." Regarding pure quantum of compensation, Snijdewind encourages companies to pay below the median, and "to bring executive compensation in line with the culture of the company and to disclose the ratio between CEO and median employee pay, separately for each industry and country." The so-called pay ratio, making its debut in the U.S. this year, is set to be one of the most-watched issues of the 2018 proxy season.

> "We think [variable remuneration] should only be paid if robust targets are made."

Misincentives

Another key issue that emerged from Proxy Insight's interviews is criticism of the work U.S. companies have done to align pay with performance. David Sneyd, associate director for governance at BMO Global Management's U.K. arm said his firm continued "to see poor corporate governance practices persisting in the U.S. market, [including] poor alignment between pay outcomes

> "We spend a long time talking about pay in the U.K., but the real problem with pay is in North America."

and company performance." This, he said, is achieved through "over-generosity for mediocre performance [and] poor disclosure of targets that make evaluating their appropriateness impossible."

Sneyd was not the only one concerned about a lack of meaningful targets. This was also highlighted by Eugenia Unanyants-Jackson, global head of environmental, social, and governance research at Allianz Global Investors. "When we look at remuneration structures in U.K. or in some European markets, there is a much closer link between strategy and pay-outs, compared with U.S. companies," she said. "We support variable remuneration, but we think it should only be paid if robust targets are made."

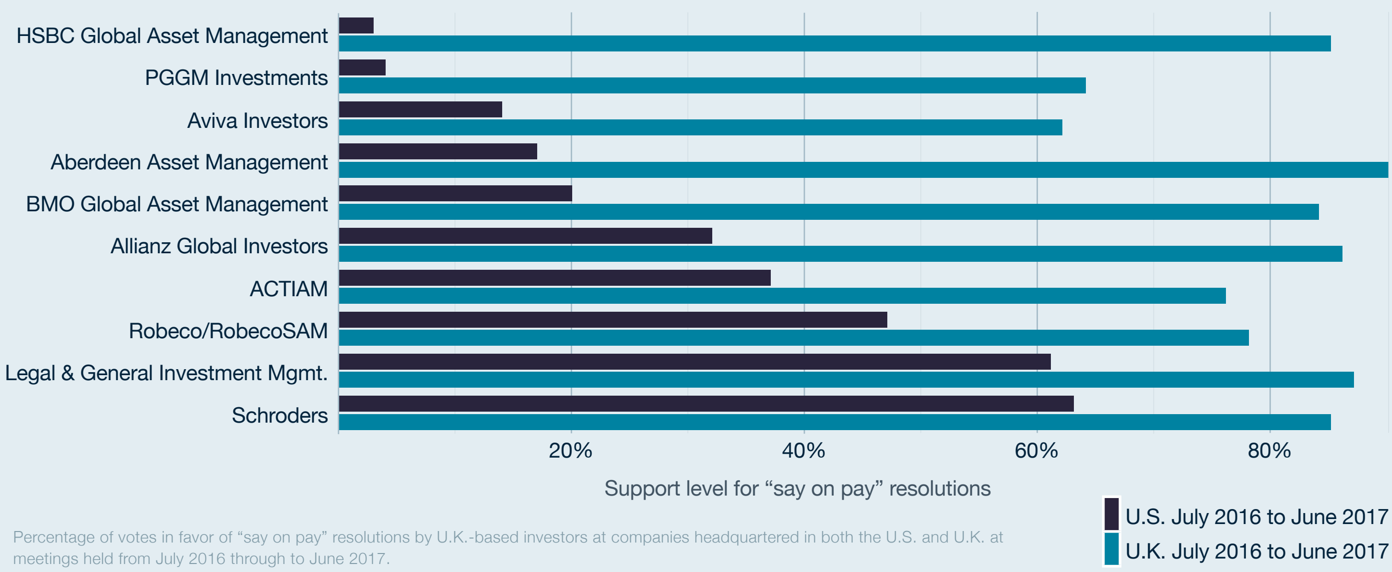
For Legal and General, it was a recent change in policy that led it to step up its opposition on pay in the U.S. this year. Under its policy, the asset manager now opposes long-term equity awards which are not based on a majority of performance shares. Clare Payn, its head of corporate governance for North America, said her team was trying "to encourage the uptick of performance based awards, to come into line with what we see as best practice and alignment with shareholders and therefore we have been voting against all executive pay plans that are too heavily tilted to time-based awards."

Unsustainable

Finally, previously niche issues are starting to intrude into the proxy voting world. Poor linking of pay and performance was also raised by Dutch Asset Manager Actiam, which opposed 63% of U.S. "say on pay" votes. However, performance targets were not the only area Actiam found wanting. Active Ownership Specialist Kristel Verhoef also pointed to a lack of sustainability targets, saying, "There remain numerous companies that have not so far included environmental and social metrics in their pay structures, which is another reason for more aggressive voting behavior in the U.S. compared to some European markets."

Such aggressive voting from major asset managers, coupled with such strongly-worded statements, cannot simply be written off as exceptions to the rule. While it is true that BlackRock, Vanguard, and State Street all supported over 93% of U.S. "say on pay" resolutions last year, such a divide between investors is unlikely to persist at a time when asset owners are becoming increasingly vocal about the stewardship of their investments. This year, many U.K. companies took action to prevent a widely-anticipated second consecutive shareholder spring. In the same way, U.S. companies would do well to consider the likelihood of a brewing revolt.

Voting on Say on Pay resolutions



Percentage of votes in favor of "say on pay" resolutions by U.K.-based investors at companies headquartered in both the U.S. and U.K. at meetings held from July 2016 through to June 2017.

THE HIT LIST

***Activist Insight Vulnerability (AiV)* employs a regression model to identify companies with a high relative probability of being targeted by an activist investor in the short to medium term. Here are some of our reporters' top predictions for 2018.**

01 BED BATH & BEYOND

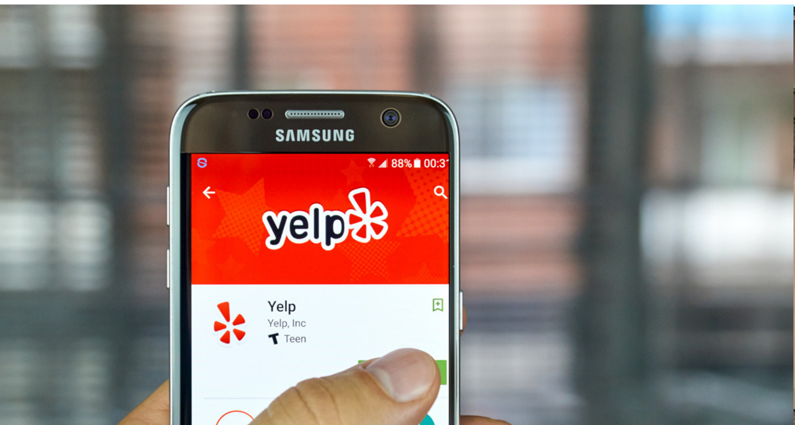
Vulnerabilities	Director support:	Performance:	Ownership:
Governance	Poison pill:	Staggered board:	Dual share class:
Sector	Consumer services	Ticker	BBBY
Market cap*	$3.1B	2017 TSR	-44.5%

Worsening performance over 2017 saw shares in the houseware retailer fall below $20 at one point during the year, down from over $80 per share three years ago. A lack of board refreshment in the past five years has also riled the heavily institutional shareholder base, such that Bed Bath & Beyond lost its "say on pay" vote in June and saw several directors receive 40% opposition. Already, five shareholders with a penchant for activism have crept onto the register, according to regulatory filings. An obvious target would be real estate, stated at $1.8 billion on recent regulatory filings. Bed Bath & Beyond already pays a dividend and is repurchasing shares, albeit slower than in previous years, but operational improvements would likely be required if the company were to remain public. Fortunately, the company may be moving into the territory of a private equity buyer on current valuations.

02 STERICYCLE

Vulnerabilities	Valuation:	Performance:	Director support:
Governance	Poison pill:	Staggered board:	Dual share class:
Sector	Industrials	Ticker	SRCL
Market cap*	$5.8B	2017 TSR	-11.8%

At a time when industrials should be cashing in on economic growth, waste management company Stericycle is failing to take out the trash. An activist-led breakup play involving the company's communication segment might assuage shareholders, who are reacting to a three-year losing streak with more aggressive voting that may presage the departure of Jack Schuler, lead director for nine years and chairman for 18 years before that. Given that Stericycle has yet to come back from account restatements in 2016 and will be embarking on further legal battles related to the scandal, having only just settled a class action lawsuit over price gouging, change could be overdue. Eight occasional activists already have toeholds in the midcap stock, albeit with a measly 0.2% collective stake, and institutional ownership is high.



> "More aggressive voting against directors has proven a powerful signal to activist investors, with weak margins and valuations also common among vulnerable stocks."

03 YELP

Vulnerabilities	Performance: 🚩	Pay support: 🚩	Activist ownership: 🚩
Governance	Poison pill: 🟩	Staggered board: 🚩	Dual share class: 🟩
Sector	Technology	Ticker	YELP
Market cap*	$3.5B	2017 TSR	10.0%

A decent performer over the past year with a toppy valuation, Yelp might seem more of a momentum play than a value one. Certainly, the stock is expensive for an activist at almost 60-times EBITDA. Yet demand for data is heating up and Yelp could become a takeover target for a company like Apple or IAC/Interactive, that could use the company's offering to bolster existing apps. Already a popular name with hedge funds, including occasional activists D.E. Shaw and Eminence Capital, and with the share price nearly 60% below its 2016 peak, the review website operator could find it is forced to consider offers in 2018. Shareholders are already starting to chafe at executive compensation, 13% objecting to 2017's "say on pay" proposal, the board is due for refreshment, and CEO Jeremy Stoppelman, a mere 7% shareholder with no special voting rights, is up for re-election in 2018. Activists have until March to nominate directors.

04 HOSPITALITY PROPERTIES TRUST

Vulnerabilities	Valuation: 🚩	Voting: 🚩	Profitability: 🚩
Governance	Poison pill: 🟩	Staggered board: 🚩	Dual share class: 🟩
Sector	Real estate	Ticker	HPT
Market cap*	$4.9B	2017 TSR	0.6%

Activist campaigns against the Portnoys tend to be hard-fought affairs. The real estate developer brothers took Corvex Management through two consent solicitations before surrendering CommonWealth REIT, and defeated an activist campaign at Five Star Quality Care in 2016. Yet Hospitality Properties Trust, a hotel property owner, is less profitable than some of its peers and has returned roughly one-third what its peer group has in the past year. Moreover, it has a habit of reappointing board members who have failed to secure majority support, which could be used to an activist's advantage. So far, the stock price has yet to drop below book value, at which point a campaign might be irresistible. Incorporation in Maryland may give lawyers fright, but there is no reason a determined activist wouldn't consider waging a campaign at the right valuation.

05 WAGEWORKS

Vulnerabilities	Performance: 🚩	Ownership: 🚩	Excess cash: 🚩
Governance	Poison pill: 🟩	Staggered board: 🚩	Dual share class: 🟩
Sector	Industrials	Ticker	WAGE
Market cap*	$2.5B	2017 TSR	-14.5%

WageWorks' larger human resources solutions peer Automatic Data Processing faced an activist campaign from Pershing Square Capital Management in 2017 and that attention might rebound unfavorably on the California-based company next year. ADP beat Ackman on the back of good returns, whereas WageWorks has a slipping stock price and a much smaller market capitalization. The fact that WageWorks is priced like a tech company, unlike ADP, provides some comfort. So too does a staggered board, though CEO Joseph Jackson is up for re-election in 2018, the first time since he was also made chairman. An activist campaign need not be hostile, however. A dividend or buybacks might be a small ask given the company's large pool of excess cash, while cost-cutting could also help if a sale wasn't the end goal.

*as of December 29, 2017.

WHERE WAS AiV ON TARGET?

Our journalists have published more than 70 stories on *Activist Insight Vulnerability* and in *Activist Insight Monthly*, including follow-ups on companies we previously analyzed. Of the 12 companies that were targeted subsequent to one of our reports, here are our favorites.

Company	**Mattel**
Activist	Southeastern Asset Management
AiV thesis	Board refreshment
Public demands	None
Gap*	Four months

2017 was an eventful year for Mattel. A new CEO, a takeover approach from rival Hasbro, and a so far passive investment from Southeastern Asset Management could presage major changes in 2018. Southeastern has a habit of turning passive stakes active but one activist unlikely to be involved is Dan Loeb, whose great-aunt created the company's world-famous Barbie doll.

Company	**Zoe's Kitchen**
Activist	Legion Partners Asset Management
AiV thesis	Cut costs
Public demands	None
Gap*	One month

Legion Partners declines to comment on its stake, suggesting it may add to its bet. In October, we said the promise of Zoe's Kitchen's 2014 listing was dwindling and management could consider broader franchising, a push into more urban areas, or retrenchment. A former CEO as chairman could also be a cause of inertia.

Company	**Cedar Realty Trust**
Activist	Snow Park Capital
AiV thesis	Cut costs
Public demands	None
Gap*	One month

Our April 2017 analysis of Cedar Realty Trust emphasized the company's sizeable discount, its underperformance relative to peers, and lack of detail in management's turnaround plans. Six months later, Snow Park Capital began agitating for a sale, pushing many of those same buttons. Shareholder discontent at 2016's annual meeting also provided a red flag for our reporters.

Company	**SuperValu**
Activist	Blackwells Capital
AiV thesis	Breakup
Public demands	Sell assets
Gap*	Eight months

The subscale grocer may be forced to sell its retail stores by Blackwells Capital, a first-time activist whose agitating followed *Activist Insight Vulnerability*'s prediction that SuperValu was in need of an urgent turnaround. Low margins and unpopular directors formed a key part of our analysis, as did the loss-making retail segment.

Company	**Whole Foods Market**
Activist	Jana Partners
AiV thesis	Sell company
Public demands	Sell company
Gap*	Six months

Did we say Whole Foods was too expensive for an activist? We must have meant its produce, because Jana Partners' campaign occupied the space between *Activist Insight Vulnerability*'s analysis and the company's sale to Amazon in mid-2017. Thankfully, we did note rising costs pressuring margins as a reason an activist intervention was warranted.

Company	**Ascena Retail Group**
Activist	Stadium Capital Management
AiV thesis	Breakup to delever
Public demands	Board representation
Gap*	Nine months

After struggling to digest the 2015 acquisition of apparel retailer Ann, Ascena soared to the top of *Activist Insight Vulnerability*'s rankings. Nine months after we first wrote about the company, Stadium Capital demanded board representation. Unfortunately, the stock price plummeted in 2017 and Ascena sought out directors well-versed in its businesses: Marc Lasry and Stacey Rauch.

*Time between AiV report and new activist stake disclosed.

The Wise Choice

Ultimate Shareholder Voting Intelligence

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