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Shareholder Activism

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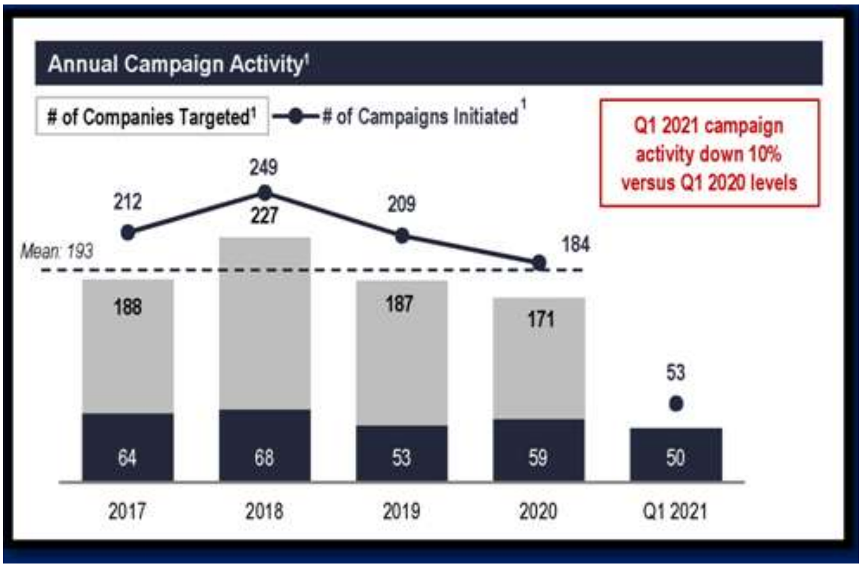
I. EVOLUTION

- Origin and evolution of activism since 1920s
- Role its frontrunners played in making it progress

Shareholder activism is a concept in which an activist investor – an individual or a group that acquires a significant stake in a public company in order to influence its functioning. Activists generally target those companies who are currently being mismanaged leading to them incurring excessive costs or not reaching their potential of profitability. Activist investors believe they have the resources to be able to rectify the issues at hand and unlock value. A small stake of less than 10% of the outstanding shares can be enough on occasions to launch a successful movement. In contrast, a full takeover bid is a lot more expensive and difficult campaign to be conducted.

The history of modern activism notably began in the 1920s. Benjamin Graham, who is considered as the pioneer of shareholder activism was the first investor to employ activism as part of his investing strategy. He came to the forefront by challenging an overcapitalized company (Northern Pipeline) to return cash to its shareholders after analysing the company's fundamentals. By the 1950s, the proxyteers, who were the original raiders, started targeting public companies. Proxyteers such as Robert Young bought significant interests in public companies from holders who were willing to liquidate their stakes and then pressurized the management. The second wave of raiders in the 1980s also woke up passive shareholders. Carl Icahn and his contemporaries set out to influence board behavior, despite the arrival of the poison pill in 1982, which is a legal device that lets companies flood the market with new stock once hostile investors acquired significant stakes. With the suspension of hostile takeovers at the end of the 1980s, and the steady growth in their ownership of the public equity of USA, the institutional investors of USA were driven to play a more active role in corporate governance. They held only around 10% of U.S. equities in 1953, but their percentage ownership increased to over 67% by 2010. In today's time, hedge funds dominate the activism market with support from other institutional investors.



II. ACTIVISM SPECTRUM

1. HEDGE FUND ACTIVISM

Hedge fund activism is the most aggressive form of activism that has the capacity to implement significant changes in the company's strategy, management, financial or board structure. It also involves implementing capital allocation strategies such as return of excess reserved cash to investors through stock buybacks or dividends. During the past decade, the number of activist hedge funds across the globe have dramatically increased.

2. VOTE NO CAMPAIGN

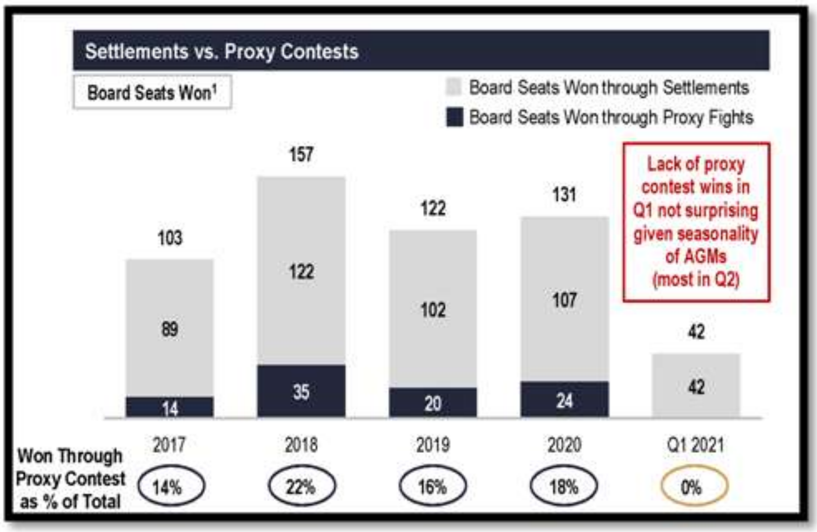
Moving down the activism spectrum are vote no campaigns where an investor (or coalition of investors) urges shareholders to withhold their votes from one or more of the board-nominated director candidates to be able to elect a more favorable board.

3. SHAREHOLDER PROPOSAL

This refers to a change in the board's governance policies or practices (examples would be to declassify the board or adopt majority voting) and a change in the company's oversight of certain functions (examples being audit and risk management).

4. SAY ON PAY

On the more passive end of the spectrum are activities usually limited to letters to a company (typically directed to the compensation committee of the board) or meetings with the company (involving the company's general counsel, corporate secretary, and/or compensation committee chair).



FACTORS CONSIDERED FOR TARGETTING COMPANIES

FINANCIAL

- Excessive Cash on Hand
- Inefficiencies in Capital Structure
- Low Market Value to Book Value
- Excessive Executive Compensation
- Less Profitable Product Lines
- Undervalued Stock Price
- Unfavorable Financial Ratios

NON-FINANCIAL

- Problematic Corporate Governance
- ESG Shortcomings
- Organizational Complexity and Strategy
- Lack of Transparency
- Issues with Related Party Transactions

- Inadequate Minority Shareholder Rights
- Highly Negative Reputation in Public
- Incompetent Board of Directors
- Ignoring Shareholder Concerns

REASONS FOR EXPANDING ACTIVISM

- Increasing Investment Capital
- Weakened Board-Controlled Defenses
- Evolving Attitudes of Institutional Investors
- Attractive Investment Returns
- Corporate Boards Inclined to Engage with Activists

III. STRATEGIES APPLIED

1. NEGOTIATIONS: It involves interacting privately with the management and is strongly influenced by the relationship between the parties, the activists' reputation and credibility. E.g. ValueAct Capital winning one board seat of Microsoft.

2. BOARD REPRESENTATION: It involves winning board seats to implement strategy and can end with settlements in order to avoid damaging publicity, high costs and extensive time loss. E.g. Carl Icahn's campaign against Chesapeake Energy Corp.

3. PROXY FIGHTS: Activists try to persuade other investors to use their proxy votes for making changes in management or directors. The proxy threat is usually enough to convince the target to settle to avoid the proxy fight. E.g. Trian Fund's proxy contest against Procter & Gamble.

4. LAWSUITS: They are aggressive and often leads to immediate implementation of the required governance changes usually caused due to shareholders being ignored and/or resisted. E.g. Carl Icahn's lawsuit against Occidental Petroleum Corp.

5. HOSTILE TAKEOVERS: It is the costliest strategy and is considered as a last resort. The person offering bears the entire burden of the intervention and its long-term consequences by eliminating managerial agency costs wholly. E.g. Elliot Management bought Athenahealth for $5.7 billion.

IV. IMPACT OF REGIONAL REGULATORY DIFFERENCES

- USA leading the industry
- Protectionist Asian policies; India's entry into the market

Trends in shareholder activism tend to begin in the United States and then extend elsewhere. There are structural reasons why activism is relatively less common in Europe; for example, majority control by families and other organizations makes it more difficult. In Asian countries like Japan and China, state-owned, listed companies are resistant to activism due to protective laws especially against foreign investors. Unlike in the United States and Europe, where investors are increasingly focused on environmental, social, and governance (ESG) issues, in Japan thus far business performance and governance have been shareholder activism's dominant focus. Some highly regulated sectors such as financial services, media, defense manufacturers, and utilities tend to have some natural insulation against share-holder actions, but that does not render them immune. Any public company can face activism. It is also on the rise in markets outside of USA. For instance, the rise of activism in Europe has many causes, including shareholder-friendly corporate laws in countries such as Switzerland presenting enticing opportunities, the recent strong performance of European equity markets, and American activists seeking more opportunities in less-crowded markets abroad. Indeed, a number of US-based funds have launched prominent activist campaigns against major European companies. For instance, Third Point LLC used its $3.5 billion stake in Swiss food giant Nestle to agitate for major changes, including selling off Nestle's stake in L'Oreal and increasing capital return to investors. European activists have also been active (example would be London-based TCI Fund Management successfully campaigned French aerospace company Safran SA to lower its offer price for Zodiac Aerospace.

Unlike more mature markets such as USA, shareholder activism is still in its infancy in India which is where the problem lies. The Indian culture is not accustomed to seeing a group of individuals challenging the functioning of an established publicly listed company. Investors have been mute spectators for so long that when someone like Narayan Murthy confronted the board of Infosys on grounds of culture, it was taken with a pinch of salt. Take the instance of Cognizant, another IT services major with significant presence in India but listed on the NASDAQ stock exchange. When activist investor Elliot Management bought a large stake in Cognizant and urged the company to take steps to boost shareholder value, it was finally accepted, although after some hesitation. Cognizant ended up agreeing to return $3.4 billion to shareholders bowing to high pressure.

Event/ Country	USA	UK	Japan	India
Financing	Equity	Equity	Debt	Balanced
External Directors	High	High	Low	Medium
Influence of Banks	Medium	Medium	High	Low
Cross Holding	Low	Low	High	Low
Role of Institutions	High	High	Medium	Medium

V. RISE OF INSTITUTIONAL INVESTORS

- Role of institutions in monitoring performance of companies
- Pushing corporates to be ESG compliant

Institutional investors, which control roughly two-thirds of the equity of public companies in the United States, have become increasingly focused on the performance of the businesses of the companies in their portfolios. The broad criticisms faced by boards of companies involved in the financial crisis and in the significant corporate frauds during the former part of the past decade topped with the dissatisfaction of stagnated growth generally experienced in the reforms relating to executive compensation have had their fair share of impact on the mindset of institutions. Taken together, these developments have tested the level of confidence they have in the ability of some boards to act in a timely and critical manner to adjust the corporate vision or address challenging issues, when necessary in the highly competitive, complex and global markets in which businesses operate today. They now express a greater willingness to listen to credible external sources with new ideas that are intelligently and professionally presented.

Tangible evidence of this evolution includes the setting up by several leading institutional investors such as BlackRock, CalSTRS and T. Rowe Price of their own internal teams to assess corporate strategies and governance practices to find ways to improve overall performance. Some institutions have transformed to maintain ESG compliant portfolios post USAs re-entry into the Paris Agreement and pledge to cut emissions in half by 2030 as was historically witnessed when Engine No: 1 managed to win 3 board seats against Exxon Mobil with a mere 0.02% stake with its focus on channelizing investment priorities while navigating the transition to a low-carbon future receiving support from major institutions such as Blackrock, Vanguard, CalSTRS and CalPERS.

ANALYSIS OF TARGET COMPANIES OF: A- 2010

Target Companies	
Green Brick Partners Inc.	Hain Celestial Group
Wendy's	Chesapeake Energy Corp.
Charles River Laboratories International Inc.	Howard Hughes Corp.
Take-Two Interactive Software	Amn Healthcare Services
Motorola Solutions Inc.	Keurig Dr Pepper

- Short and long term impact of activism on targets companies

After plotting the data of the targets of the top 10 activist hedge funds in terms of AUM, positive short term annual returns in the share price and revenue of 14.67% and 28.50% respectively were observed in 2011 over 2010. Such magnitude of returns on revenue were not seen again and the growth stagnated for the same. The share price returns peaked in 2013 after which a steady decline of growth was seen till 2019.

B-2014 TO 2021

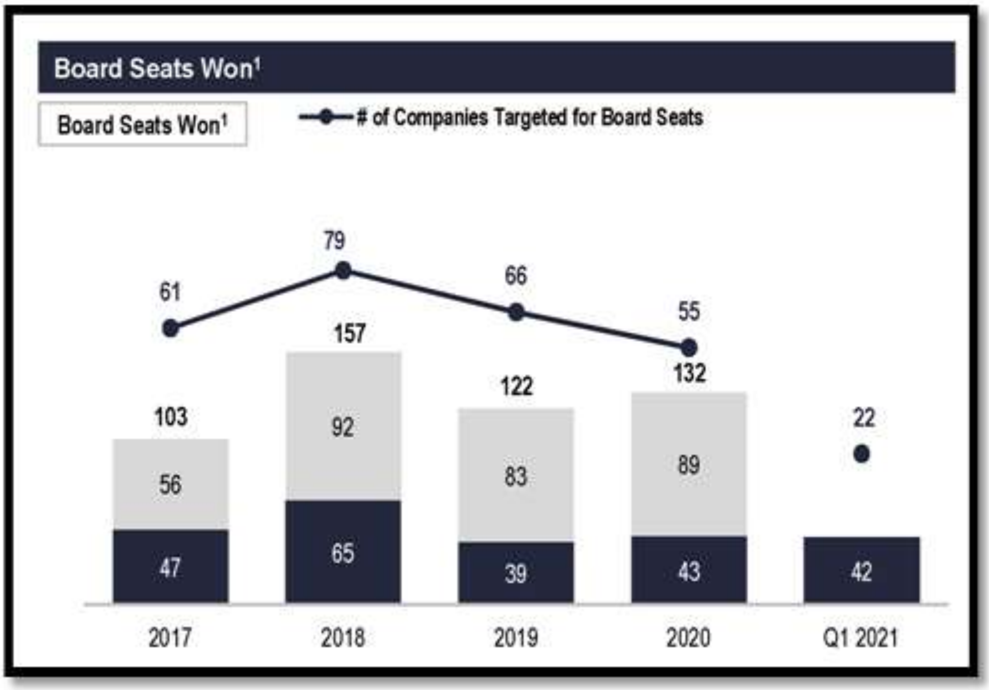
After plotting the data of the targets of the top 10 activist hedge funds in terms of AUM with T being the year in which the activist campaign got carried out, what could be seen was that there were positive short term annual returns in the share price of 9.05% and healthy returns were seen till before T+4 where negative returns were recorded which was followed by a spiked rebound in T+5. Revenue figures did not seem affected in the short or long term and stagnated at an average growth of 1.20% through the decade.

Target Companies	
General Electric Company	**Marathon Petroleum Corporation**
Juniper Networks	**Chipotle Mexican Grill**
PepsiCo	**Lowe's**
Twitter	**eBAY**
Canadian Pacific Railway	**Qualcomm Incorporated**
Advanced Auto Parts Inc	**The Walt Disney Company**
Freeport-McMoRan	**First Energy**

VI. IMPACT OF COVID-19 ON ACTIVISM

- Anticipation and reality of the impact of COVID-19
- How is the activist industry recovering from it

When COVID-19 was first traced in USA, some analysts predicted that the resulting volatility in the market would lead to a sharp spike in activism. The thought was that the depressed share prices and the uncertainty caused by the pandemic would provide activists with a cheaper entry point and a distraction to catch boards and management teams off guard. Instead, activism slowed considerably as COVID-19 spread. In USA, activists launched 34% fewer campaigns and targeted 25% fewer companies in 2020 than they had in the previous year. The fourth quarter of 2020 saw a rebound in activity. During the first quarter of 2021, the number of campaigns launched increased 48% YoY. Activists initiated 37 campaigns, almost half of 2020's total activity. They faced unprecedented uncertainty and virtually engaging in proxy contests became difficult especially at a time when institutional shareholders pressured activists to settle pre-pandemic campaigns so that the issuer could focus on addressing its near-term liquidity needs without the distraction of the ongoing activism campaign. Continuing to pursue campaigns could have led to a loss of reputation. Declining valuations also fueled a revival of takeover defense mechanisms like poison pills that had fallen out of favor. Balance sheet activism had largely disappeared as companies prioritized preserving cash, and executive compensation received renewed scrutiny. As the economy begins to reopen, dissident shareholders will also likely look to hold boards and management teams accountable for



perceived failed oversight or mismanagement during the pandemic. As the economy stabilizes and clearer distinctions in performance develop between companies in the same industry, it will be easier for activists to identify and target underperformers. With several industries ripe for consolidation, M&A activism will strengthen.

WHAT LIES AHEAD

- Emerging trends of the activist industry such as ESG
- Role of alternative data, converging strategies and succession

The post COVID scenario provides activists with a window to drive a narrative for why a change is needed citing reasons of lack of a resilient board of directors and management team who could quickly and successfully pivot their business model in response to the challenges that cropped up. Climate proposals have received record support pushing for board diversity and expertise ever since the onset of the Biden Administration. This year, 98% of General Electric shareholders approved a resolution asking the company to explain how it intends to achieve net zero emissions in accordance with the Paris Agreement. The SEC said the efforts institutional investors pay to their fiduciary duties to their clients before voting will be essential in driving the ESG momentum. There have been talks on the sustainability of the alpha generated from activism since everyone else is catching up fast on aspects like engaging with major stakeholders, building long term strategies and optimal capital allocation plans which can potentially reduce the value that activists bring to the table. That being said, the periods following the past two cycle downturns have generated anomalies that opened the door to activism regardless of the enforced governance measures or regulations.

An important aspect to generating alpha has been the surge in the use of alternative data. What was only being used by quantitative strategy funds such as D.E. Shaw up until recently has also dispersed into the more fundamentally oriented fund businesses to the extent that nearly 60% of hedge funds who use next-generation data are doing so to support their fundamental approach. It is expected that even the traditional institutional investors such as Vanguard or Blackrock will get keen on hiring more data analysts soon for their fundamental businesses to ensure the sustainability of their actively managed portfolios.

Recent trends have shown convergence of styles of different industry players. On the private equity side, this has been seen in the form of minority investments being made in public companies to engage and agitate change rather than acquiring the company wholly. On the hedge fund side, strategies such as complete acquisition of companies and private investments in public equity to provide liquidity have been utilized. For example, last year, Elliott teamed up with Fidelity and Bluescape to invest $1.4 billion in utility CenterPoint Energy.

The next decade will be monumental for defining this industry which has had so much stability when it comes to the top hedge fund activists for quite some time. Jeff Ubben's departure from Value Act Capital can be thought as a first of potentially multiple turnovers at the forefront of activism. Carl Icahn, who turned 84 years old in

February, announced in October that his son, Brett Icahn, is rejoining his fund and that Brett is Carl’s likely eventual replacement as chairman and chief executive. Similar questions will be asked for Trian’s Nelson Peltz who is 78 years old and Elliott’s Paul Singer who is 76 years old.

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