THE ACTIVIST REPORT

13D Monitor

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What's the Fate of Fannie and Freddie?

There have been 936 recipients of TARP money from the US Treasury in connection with the 2008 bailout of the financial system. In total, the US Treasury had disbursed $608 billion of which $380 billion has been returned with another $198 billion has come back to the government in the form of dividends, interest and fees (all data as of November 26, 2013). The three largest recipients of TARP money were Fannie Mae/Freddie Mac ($187 billion), AIG ($68 billion) and General Motors ($51 billion). The Fed contributed an additional $112.5 billion to AIG, bringing its total assistance to $181 billion.

The Government recently announced that it would sell its remaining shares in General Motors by the end of the year. It stands to lose $10 billion on its investment, based on GM's current stock price. Combined with the Treasury Department's already realized loss of $1 billion on its smaller investment in Chrysler, that brings the total cost to taxpayers of rescuing two of the Detroit Three to $11 billion.

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Under the Threshold Activism Below 5%

NEW Abercrombie &Fitch

On December 3, 2013, **Engaged Capital** sent a letter to the Board of **Abercrombie & Fitch. Co (ANF)** urging them not to renew CEO Jeffries' employment agreement when it expires on February 1, 2014 and to immediately commence a CEO search for candidates with relevant retail apparel and turnaround experience. Engaged believes that the Company's continuing underperformance is a result of a failure of leadership. Engaged notes that management's strat-

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QUOTE OF THE MONTH

"It was not long ago the activist moniker had a distinctly negative connotation. That view of shareholder activists ... is not necessarily the current view." SEC Chair Mary Joe White, 12/3/13.

10 Questions with Stephen Gill

Stephen M. Gill is a Partner at Vinson & Elkins LLP. Stephen concentrates his practice on mergers & acquisitions for public and private companies and private equity firms, including takeovers and takeover defense as well as shareholder activism. Stephen has represented many companies in the Energy sector and was able to make the time to sit down with us for this month's edition of 10 Questions to discuss activism in the Energy sector.

13DM: In 2009, 2010 and 2011 13D Monitor reported on a total of four activist 13D filings in the oil and gas sector. In 2012 and 2013, there have been a total of 12.

What are the primary factors that led to the rise of shareholder activism in the energy sector?

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STEPHEN GILL (cont'd. from pg. 1)

SG: The North American energy sector has experienced a dramatic surge in shareholder activism in 2012 and 2013. The increase of Schedule 13D filings in the oil and gas sector is only one of several indicators. Many high-profile activist campaigns in the energy industry took place under the 5% threshold for Schedule 13D filings. For example, Elliott Associates waged a proxy contest against Hess Corporation with a 4.5% stake, Third Point owned only 1.3% in Murphy Oil when it launched its campaign against the company, and shareholders led by First Pacific Advisors holding merely 0.3% pushed out the executive chairman of Occidental Petroleum. Moreover, in our experience most activist situations in the energy industry remain undisclosed because they are resolved out of the public eye.

As for the factors, there are several industry characteristics that made the energy sector a leading target for activists. First of all, the North American shale boom has resulted in record capital expenditures by oil and gas companies. At the same time, increased competition and production has reduced prices and squeezed profits. In 2012, only 30% of oil and gas companies generated more cash than they spent. This is the lowest level in five years. However, many shareholders are no longer content with companies that promise rapid growth and profits at some unknown point in the future. Second, many energy companies have tangible assets that can easily be sold or spun off to unlock shareholder value. Lastly, fair or not, there is a perception that the entrepreneurial culture of the energy sector has resulted in somewhat weaker checks and balances on corporate governance.

13DM: What have been the characteristics of the energy companies that have been targeted by activists?

SG: Many target companies have had profitability issues. Energy is a capital intensive, long-term business. Drilling for oil and gas, laying pipelines and building storage facilities requires significant capital investments that may not return profits for several years.

However, several targets were actually profitable enterprises but came under fire for not returning cash to their shareholders. Those companies were pressed to pay higher dividends or to initiate share buyback programs. A good example is Transocean, which agreed to pay out a larger dividend following an activist campaign.

Furthermore, most targets in the energy sector were diversified companies with non-core assets. Many energy companies have both upstream (i.e., exploration and production) and midstream operations (i.e., transportation, storage, and wholesale marketing of oil and gas). Capital markets generally reward pure players that focus either on upstream or midstream operations because investors prefer to diversify themselves. Therefore, energy companies with significant non-core assets became the target of activists' push for spin-offs or other divestitures. A perfect example is Hess Corporation, which became a target because it has upstream, midstream and downstream operations as well as certain investments outside the petroleum supply chain (e.g., a hedge fund). Another recent example is QEP Resources, which was pushed to form a master limited partnership, or MLP, for its midstream operations.

Lastly, almost all target companies in the energy sector came under attack for insufficient corporate governance. Most of the time, the targets have had boards with long-tenured directors who were perceived as being too close to the CEO. At Hess, seven directors had been on the board between 10 and 34 years, and 8 of the directors were between the ages of 71 and 81. Other targets were criticized for compensation practices or special perks for executives. A good example is Chesapeake Energy Corporation, which had a program that allowed its founder to participate and invest in new wells drilled on the company's leaseholds. Other targets were attacked for related party transactions. A case in point is SandRidge Energy, where the CEO and his son were accused of "front running" by acquiring mineral rights from third parties and subsequently leasing those rights to SandRidge for a profit.

13DM: Who are the well-known activists that have focused on the energy industry? Do you see 'occasional activists' in the energy industry, too?

SG: Among the well-known activists who have focused their efforts on energy

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STEPHEN GILL (cont'd. from pg. 2)

companies, Carl Icahn certainly stands out. He waged several campaigns against companies like Chesapeake Energy, CVR Energy, Transocean and Talisman Energy. Another activist who has focused on the energy sector is Barry Rosenstein. His hedge fund Jana Partners invested in Marathon Petroleum, Oil States and QEP Resources. Other well-known activists who invested in the energy industry include Greenlight Capital (Oil States), Third Point (Murphy Oil), Elliott Associates (Hess) and Relational Investors (Occidental Petroleum).

As far as 'occasional activists' are concerned, we're beginning to see them more and more in the energy sector. TPG-Axon Capital's proxy fight against SandRidge Energy is only one high-profile example. More and more of our private equity clients are coming to us for advice on activism strategies when they become dissatisfied with minority investments. Just recently, one of our clients, who held approximately 25% in a portfolio company, nominated a slate of directors and commenced litigation in Delaware against the company and its incumbent board.

13DM: What was the most successful campaign theme activists used in their pursuit of energy companies?

SG: The campaign theme that seems to get the most traction with investors in energy companies is corporate governance failure. Shareholder activists have very successfully demanded stronger boards capable of controlling powerful executives and founding families of energy companies. For instance, an ally of Carl Icahn told Chesapeake's founder, "You are a genius oil and gas man but even the best executives need a board." This theme has been used very successfully over and over again because of the energy industry's 'Good ol' Boys Club' reputation.

13DM: Which themes from energy targets defending against activists resonated well with shareholders? Which did not?

SG: Let's start with what most often doesn't work: The long-term vs. short-term argument. Accusing activists of unhealthy short-termism misses the mark if your average investor is holding its shares for less than 9 months. Therefore, executives and directors are well-advised to focus on near-term and mid-term results. This may be regrettable because whether shareholder activism is beneficial or detrimental to our economy in the long term is an important macroeconomic question. But the ugly truth is that in a campaign your investors couldn't care less whether Martin Lipton or Lucian Bebchuk is right on this issue. All they care about is their return on investment in the near term and so companies need to focus on that, too.

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13DM: A large number of public energy companies are organized as a master limited partnership, or MLP. Are MLPs potential targets for shareholder activists as well?

SG: Most MLPs are unlikely to become a target of shareholder activism for a simple reason: a typical MLP is fully controlled by its sponsor who appoints all directors to the board. Consequently, activist shareholders cannot use the threat of a proxy fight for board seats as leverage to push their agenda. Therefore, absent extraordinary circumstances, only MLPs that don't have a sponsor and do have annual board elections are at risk.

13DM: Have you noticed a change in executive suites and board rooms of your energy clients as a result of the rise of shareholder activism?

SG: Yes, absolutely. Shareholder activism clearly has gotten the attention of the CEOs and boards in the energy space. In fact, this fall we conducted a road show on shareholder activism in the energy sector for executives and board members of public companies in cooperation with an investment bank and a public relations firm. The interest in this subject matter has been overwhelming and the concern has been palpable in our conversations with our clients.

We also believe that shareholder activism has started to influence energy deal activity generally. To give you an example, in the third quarter of 2013, divestitures drove deal activity with 36 total transactions, representing 84% of the total deal volume in the energy

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STEPHEN GILL (cont'd. from pg. 3)

sector. This divestiture wave is partly fueled by shareholder activism concerns because activists push energy companies to simplify their structure by selling or spinning off non-core assets. At the same time, activism in the energy sector has also created obstacles for M&A activity because many executives and boards may be less willing to consider large transactions if such deals could make them targets of activists.

13DM: How can an energy company reduce its vulnerability to shareholder activism?

SG: Preparation, preparation, preparation. In essence, become "white paper ready" before an activist shows up on your doorstep. Assemble a small core response team (lawyer, banker and public relations firm) to be prepared to respond promptly and to analyze the company as an activist would. Monitor your shareholder base. Implement an ongoing shareholder outreach program. Pay attention to the early warning signs, such as close "say-on-pay" votes or high numbers of withhold votes in director elections. Periodically self-evaluate your board composition, looking at factors such as directors' length of tenure, relevant experience, age, and independence. Review your structural defenses, such as whether or not you have a poison pill "on the shelf" or whether your bylaws permit shareholders to act by written consent or to call a special meeting. And, most importantly, have the board thoroughly examine strategic alternatives proactively and pre-emptively to address issues that may make the company vulnerable to an activist (e.g., are there non-core assets that should be divested?). Ironically, this preparation may lead companies to make positive changes for shareholders without any activism involvement and without the pressure.

13DM: Aside from the rising number of targets in the energy industry, what would you say is the most significant development of shareholder activism in 2013?

SG: The astonishing success of shareholder activism against M&A transactions. There has always been shareholder opposition to public M&A deals, but it used to take a different form – shareholder litigation in the form of strike suits. Opposition to M&A deals in the form of proxy fights or "vote no" campaigns used to be a rare event and was rarely successful. This year has seen an unprecedented number of highly successful campaigns against M&A transactions. In at least seven high-profile transactions, the parties were forced to postpone the shareholder vote and improve the deal terms. In fact, we represented an 'occasional activist', an investment fund and long-term shareholder of Clearwire, in its proxy fight and litigation against the Clearwire-Sprint merger. Our strategy of combining a proxy fight with litigation proved to be highly successful as it resulted in four postponements of the shareholder vote and an aggregate increase of the merger consideration by almost 70%.

We expect this to become a new trend. Obtaining shareholder approval of public M&A deals may become much harder in the years to come. This might impact price negotiations with target boards in the future because buyers may decide to reserve some dry powder for subsequent negotiations with rebellious shareholders. Having said that, not all transactions are at risk. Primary targets are MBOs and controlling shareholder buy-outs because it is easy for activists to raise questions about whether there were arm's length terms.

13DM: What future trends do you see in shareholder activism in the energy industry and elsewhere?

SG: Shareholder activism in the energy industry will continue to increase. Activists will be drawn to energy companies so long as oil and gas prices remain at stable levels because this protects them against losses. Moreover, shareholder activists' recent successes will attract copycats who try to mimic the successful strategies. For example, we expect to see more and more 'occasional activists' such as private equity funds employing activism strategies – in the energy industry and elsewhere.

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FANNIE MAE AND FREDDIE MAC (cont'd. from pg. 1)

The AIG bailout worked better for the government. At AIG, the Treasury Department had preferred shares that paid a 10% dividend. However, the Treasury Department exchanged $40 billion of these preferred shares for new ones that effectively paid no cash dividends to taxpayers. If it had paid the originally agreed 10 percent dividend on all these and other preferred shares, AIG would have paid roughly $20 billion from the beginning of 2009 to the end 2012. Instead, the preferred shares were converted into common stock, which the government later sold. Additionally, in 2009 the Federal Reserve cut the interest rate on a big loan to AIG. At the time, the company said that would save it $1 billion a year in interest. Ultimately, the Treasury Department sold its entire 92.1% position in AIG's common stock and made a $5 billion return on its investments. The Federal Reserve ultimately realized a profit of about $17.7 billion from its role in AIG's bailout. However, the Governement would have collected over $20 billion more in profits had it not decided to unilaterally amend the terms of its securities for the benefit of AIG.

Now, let's look at Fannie Mae and Freddie Mac. There, the government ultimately provided $187 billion of assistance in exchange for a "Super-Preferred Stock" that paid a 10% dividend, and a warrant to acquire 79.9% of each Company's common stock for virtually no consideration. At this time in 2008, the government had the option under the newly created Housing and Economic Recovery Act (HERA), to place the Companies into conservatorship or receivership. They chose to place Fannie Mae and Freddie Mac into conservatorship. This left approximately $34 billion of privately held preferred shares (the "Junior Preferred Shares") outstanding as well as the common stock. Had the government decided to place the Companies into receivership, they would have had to take Fannie and Freddie's debt on to the government's balance sheet, something they were unwilling to do.

So, they appointed a conservator, presumably to conserve the Companies as opposed to a receiver who would liquidate the Companies. With the condition it was in after 2008, it was hard to see how Fannie and Freddie would ever again be profitable, much less be able to generate any cash flow above the 10% dividend. However, in 2012, Fannie and Freddie started showing substantial unexpected profit. Investors actually saw a possibility of the Companies being able to pay off the government's preferred leaving value in the Junior Preferred and possibly the common stock. With this possibility now looking likely, in August of 2012, the US Treasury (holders of the government's preferred shares) and the Conservator appointed by the US Treasury and who runs Fannie and Freddie, amended the Super Preferred Stock (the "Sweep Amendment") to provide that in lieu of the 10% annual dividend, the Super Preferred Stock will now sweep all profits of Fannie and Freddie. Moreover, these profits will not be used to redeem the Super Preferred Stock or otherwise reduce the balance owed by Fannie and Freddie, essentially wiping out private investors, and liquidating, rather than conserving, the Companies.

In June of 2013, the Treasury swept $66.3 billion of profits form Fannie and Freddie, only $4.7 billion of which would have been due prior to the Sweep Amendment. By June of 2013, Fannie and Freddie had paid off $132 billion of the $187 billion and are expected to pay back the entire amount plus the 10 percent interest in 2014. However, due to the 2012 amendment, the full amount of the Super Preferred Stock will remain outstanding and all amounts made by Fannie and Freddie will continue to be swept by the government and will not enure to the benefit of the Junior Preferred Stockholders and the common stockholders.

In July of 2013 Perry Capital, who began purchasing Fannie and Freddie securities for its institutional clients in 2010, filed a lawsuit against the US Government. Perry essentially makes four claims:

1. **The Sweep Amendment directly undermines the rules of conservatorship.** Soon after HERA passed, the Treasury determined that

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FANNIE MAE AND FREDDIE MAC (cont'd. from pg. 5)

Fannie Mae and Freddie Mac should be placed into conservatorship. There were many benefits to this decision. Particularly, by avoiding nationalization, Treasury did not have to consolidate the balance sheets' of the companies in the national debt. However, the Treasury has obligations under conservatorship. HERA explicitly states that under conservatorship the companies are to be restored to a "sound and solvent condition" and to "conserve [the companies'] assets and property." The Sweep Amendment deprives Fannie and Freddie of any ability to rebuild capital or accumulate net assets and therefore does exactly the opposite of "preserv[ing] and "conserv[ing]" their assets. In fact, the press release issued by the Treasury regarding the Sweep Amendment emphasized that the amended agreement was the "next step toward responsibly winding down Fannie Mae and Freddie Mac." The Sweep Amendment is thus inconsistent with the Treasury's statutory responsibilities.

2. **The Sweep Amendment directly undermines Treasury's statutory requirement for providing financial assistance to the companies as explicitly stated in HERA.** HERA also provided temporary authority to Treasury to offer financial assistance to the Companies. When offering financial assistance, Treasury was required to determine that financial support was necessary to "provide stability to the financial markets," "prevent disruptions in the availability of mortgage finance," and "protect the taxpayer." When making these determinations, Treasury, among other things, had to consider "the Corporation's plan for orderly resumption of private market funding" or "the need to maintain the corporation's status as a private shareholder company." Because the Sweep Amendment essentially wiped out the value of all private investors in Fannie and Freddie, Treasury's actions were clearly inconsistent with "the orderly resumption of private market funding or capital market access," and the "need to maintain the Corporation's status as a private shareholder-owned company."

3. **Treasury acted beyond its statutory authority because its authorization to purchase securities of Fannie and Freddie and to set the "terms and conditions" of those purchases expired on December 31,**

2009. Treasury's temporary statutory authority to purchase securities issued by Fannie Mae and Freddie Mac expired at the end of 2009. Because the Sweep Amendment fundamentally changes the nature of the Super Preferred Stock to allow Treasury to recover all the net income of Fannie and Freddie as long as they remain in operation, the agreement impermissibly altered the terms and conditions of the securities and otherwise constituted a constructive purchase of a new security in violation of this sunset provision.

4. **By unilaterally wiping out all minority shareholders, the Sweep Amendment is not consistent with the fiduciary duties majority shareholders owe to the corporation's minority.** Under applicable principles of corporate law, a corporation's controlling shareholder owes fiduciary duties to the corporation's minority shareholders. Treasury, as the dominant shareholder of Fannie and Freddie, ignored those duties when it conspired to enter into the Sweep Amendment and expropriate the value of the Junior Preferred Stock for the sole benefit of the federal government. Indeed, there is no evidence that Treasury considered the interests of other holders of Fannie and Freddie securities at all, making its actions unlawful.

So, the question is not what Fannie and Freddie junior securities are worth today. They are worth nothing if the government gets all of the Companies' profits. The question is whether the government is going to be able to get away with this and if not, what will the Junior Preferred and common be worth if the Companies are allowed to retain its profits after paying off the government's preferred. Clearly the answer depends on the continued growth of Fannie and Freddie's businesses and whether the implicit guarantee of its securities by the government will continue.

President Obama has recently said that it is time to "wind down" Fannie and Freddie, and there is no shortage of Congressional proposals to put Fannie and Freddie out of business. In the House, Republicans want mortgages funded pretty much entirely by private investors. In the Senate, a bipartisan bill would keep the government involved with a more limited mortgage guarantee designed to keep mortgages more widely available and affordable than those backed only by private investors.

But before we automatically write off the

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FANNIE MAE AND FREDDIE MAC (cont'd. from pg. 6)

government's implicit guarantee and consider the wind down of Fannie and Freddie as a foregone conclusion, let's look a little at their history, where they are now and what the repercussions of a wind down would be.

Fannie Mae was founded in 1938 during the Great Depression as part of the New Deal. It is a government-sponsored enterprise, though it has been a publicly traded company since 1968. Its purpose is to expand the secondary mortgage market by securitizing mortgages in the form of mortgage-backed securities, allowing lenders to reinvest their assets into more lending and in effect increasing the number of lenders in the mortgage market by reducing the reliance on locally-based savings and loan associations. Freddie Mac was created in 1970 to expand the secondary market for mortgages in the US.

In 1992, President George H.W. Bush amended the charter of Fannie Mae and Freddie Mac to reflect the Democratic Congress' view that the two companies "... have an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while maintaining a strong financial condition and a reasonable economic return." Fannie Mae and Freddie Mac have striven to improve home ownership of low and middle income families and in underserved areas. They have effectively made it possible for many families to receive affordable 30-year fixed-rate mortgages and have provided the continuous availability of mortgage credit under a wide range of economic conditions.

However, during the housing boom, more than 60% of mortgages in the US $12 trillion mortgage market were funded by private investors without government backing. Since then, private investors essentially have fled the mortgage finance market. Nearly 90% of mortgages written today are backed by Fannie or Freddie. The Treasury has been talking about a plan to move from the government to private lenders. But very few private lenders are willing to finance home mortgages under current rules. The only way to get them back into the market is to offer them great financial incentives—which will result in higher costs for borrowers in the form of higher mortgage rates. That's going to make it difficult to pull off one of the other major goals of Fannie and Freddie reform: keeping mortgages widely available and affordable, especially for first-time buyers.

Home ownership for the middle class or those entering the middle class is still the most significant way of developing intergenerational wealth and homeownership has declined to a 17-year low. Moreover, it was the increase of mortgage financing by the private market and the creation by the private market of credit default swaps that largely led to the financial crisis of 2008. There is also one major political hurdle to winding down Fannie and Freddie. Until there's much stronger evidence that private mortgage financing is coming back, any effort to wind down Fannie and Freddie would dampen a housing recovery that has only recently begun to gain momentum. And no member of Congress or the President wants to run the risk of having his or her name on a law that slows or reverses that recovery.

On some level this story is also about the varying constituencies involved, mainly the government (commonly referred to as "the taxpayers") and the hedge funds who own Fannie and Freddie junior securities. The frequent question you hear is how can the government agree to a plan that enriches the hedge funds? First, let's clarify who comprises these hedge funds. While certainly it includes the hedge fund managers, who few sympathize with, it also includes their investors – pension funds, teachers, firefighters, charitable endowments and educational endowments. If you are going to refer to any losses that the government takes as losses of the "taxpayer" certainly it is fair to make the same analogy for the hedge funds.

Second, while hedge funds would benefit from the continuation of Fannie and Freddie with the government's implicit guarantee, hedge funds take risk in making investments and it should not be frowned upon to reward them for that risk. These same hedge funds were large buyers of post bailout securities in companies like AIG and GM, propping up the price of those securities, which greatly benefitted the government and the taxpayer. Nobody was complaining about hedge funds then.

But most of all, it is important to think of the third constituency who does not have a seat at the table – the middle class who rely on Fannie and Freddie. When it comes down to it, this is who the government should consider first and foremost, from both an economic and a political perspective.

Fannie and Freddie stockholders are not asking for reduced interest like the government gave AIG. Nor are they asking or expecting the government to take a loss on its bailout like they did with GM. They are just asking for them to uphold the deal they originally made and that stockholders relied upon when investing in Fannie and Freddie. Under this scenario, the government gets back its $187 billion plus ten percent interest, the Junior Preferred Stockholders would be next in line and the remaining value would flow to the common stock, 80% of which would continue to be owned by the government, giving them more than enough incentive to continue their implicit guarantee.

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UNDER THE THRESHOLD (cont'd. from pg. 1)

egy of investing hundreds of millions of dollars to expand the Company's domestic footprint has resulted in a materially overbuilt U.S. store base which has led to years of store closures and asset impairments. Engaged also notes management has pursued the same "spendthrift capital allocation discipline" internationally through a high-risk flagship store strategy which has saddled the Company with costly and underperforming stores in Europe and Japan. Also, Ruehl and Gilly Hicks, the Company's two newest brands were costly failures. Altogether, according to Engaged, investors have suffered through asset impairments and operating losses of over $500 million during the past six years alone, operating margins that have deteriorated from over 21% in 2007 to below 5% today, and return-on-capital declined from over 20% to levels below the Company's current cost-of-capital. While Engaged believes that investors should benefit from recently announced expense reductions of over $130 million in fiscal 2014, they note these changes are coming a full six years after margins and returns drastically declined. In the letter, Engaged discusses that the Company's management team has a reputation for habitually under-estimating and under-executing on the changes needed to remain competitive in the fast moving teen apparel market. Since 2000, the Company has only generated positive same-store-sales five times while experiencing material declines in eight of the last fourteen years, and over this time period, compounded same-store-sales have declined by 41%. However, despite the poor leadership, Engaged notes the Company still maintains brands with domestic and international appeal, a highly profitable direct-to-consumer business, and significant cash flow generation potential. The Company has consistently been cited as an attractive target for private equity investors, and Engaged believes a sale may be the best option for shareholders. Engaged is concerned that the Company has not identified any internal successors to Mr. Jefferies and believes the renewal of Jeffrie's employment contract would be a direct contradiction to what the Company needs and what shareholders want. Engaged points to the say-on-pay voting results of the Company's recent annual meetings as evidence of shareholder unrest. Shareholder support for ANF's say-on-pay proposals was 56%, 25%, and 20%, for 2011, 2012, and 2013, respectively, versus an average approval rating for say-on-pay proposals in the S&P 500 of approximately 90% in each of the past three years.

NEW

On November 20, 2013, **Orange Capital, LLC** announced its intention to nominate four independent directors to the Board of **Strategic Hotels & Resorts, Inc. (BEE).** Orange Capital, who retained proxy solicitation firm, Okapi Partners LLC, owns approximately 4% of the Company's outstanding common shares. Orange Capital recommends that the Company explore strategic alternatives, set a strategy for realizing NAV and reform the Company's governance. Orange Capital believes the Company's underperformance is directly linked to its poor corporate governance practices and the lack of a coherent strategy to maximize value. In its presentation, Orange Capital stated its belief that the intrinsic value of the Company's assets are worth up to $14 per share (presently trading at $8.91 per share), and it is skeptical about the Company's ability to compete effectively as an acquisition/growth vehicle. Orange Capital asserts that more than any single idea, the Company and its Board need a cultural change that only comes with the election of new, independent directors. Orange Capital points out that on every key governance issue, the Board has failed to respond appropriately to shareholder concerns - Orange Capital explains there are problematic compensation practices, consistently low average director support, failure to consider outside candidates in CEO search, no separation of Chairman and CEO, a long record of ISS and Glass Lewis concerns and structure defenses that Orange Capital believes serve to unnecessary entrench the Board and management. Orange Capital also believes that the Company should have interviewed other qualified candidates instead of following an "outdated CEO succession plan" and appointing Rip Gellein as CEO.

UPDATE

On November 21, 2013, **Barington Capital Group, L.P.** announced that it retained Houlihan Lokey to undertake an independent review of Barington's recommendations for **Darden** to improve the long-term performance of the Company. Once the review is completed, Barington will share its recommendations with the Company and its shareholders in a detailed presentation. MacKenzie Partners has also been retained to advise Barington. **(To read more about the ongoing situation at Darden, please refer to page 9)**

UPDATE

On December 4, 2013, Icahn announced that he will submit a precatory proposal to Apple's shareholders at the Annual Meeting, calling for a $50 million buy back in stock. **(To read more about the ongoing situation at Apple, please refer to page 9)**

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UNDER THE THRESHOLD - ONGOING SITUATIONS

On August 13, 2013, **Icahn** tweeted [@Carl_C_Icahn]: "We currently have a large position in **APPLE**. We believe the company to be extremely undervalued. Spoke to Tim Cook today. More to come." Icahn believes that the Company should buy back $150 billion of its common stock. Icahn says that they can do this by borrowing the money at less than 3%, a unique opportunity, and they would still have a ten times interest coverage ratio and $146 billion of cash on the balance sheet, a portion of which would have to be repatriated if necessary. Icahn believes that a tender offer at $525 per share could result in a $625 stock price if the P/E ratio remains the same and assuming earning do not increase, and he believes they will. In three years, Icahn expects shares to appreciate to $1,250, assuming the market rewards EBIT growth of 7.5% per year with a more normal market multiple of 11x EBIT. Icahn had dinner with Tim Cook and conveyed his recommendation to him. Icahn had since increased his position in Apple to $2.5 billion with intentions to buy more. To invalidate any criticism that he would not stand by his thesis in terms of its long term benefits to shareholders, he states that he would withhold his shares from the proposed $150 billion tender offer. Icahn also said that he would explore running a proxy fight if necessary.

CF Industries is North America's largest nitrogen fertilizer manufacturer and one of the lowest-cost producers globally. CF currently trades at an unwarranted discount to fertilizer and commodity chemical peers. **Third Point** believes its structural cash flow generation strength is misunderstood and that management should deliver a much larger dividend to its shareholders. Such a dividend would highlight the sustainability of its cash flow generation and lead to a substantial re-rating. CF's access to low-cost North American natural gas – the primary input in nitrogen fertilizer production – gives the company a structural, sustainable margin capture relative to global peers with higher input costs. These same competitors provide a floor for the nitrogen fertilizer price, because they idle production when the price nears their cost ("the cost floor"). The spread between CF's production cost and that of the higher cost producers is a sustainable stream of cash flow for CF, with limited volatility. Using an onerous set of assumptions for this spread ($5 Henry Hub/natural gas input cost and $275 per ton nitrogen fertilizer price), Third Point estimates that this cash flow stream would be ~$1.2 billion annually (operating free cash flow less maintenance CapEx, post expansion). On today's equity value, that would mean CF is currently trading at an 11% free cash flow yield using these onerous assumptions. Given the low-risk profile of this portion of CF's cash flow, it should receive a bond-like multiple (e.g. 7 - 8% yield), which alone implies significant upside to the current share price. CF management has the ability to highlight the value of this stable cash flow stream by paying a significant portion of it as a dividend. A high dividend payout would still leave CF's leverage well below the 3x debt to EBITDA criteria that Moody's recently established as adequate to maintain their current debt rating of Baa2. Additionally, when the nitrogen price rises above the "cost floor," which often happens when demand exceeds supply (2012 average price $408/ton), CF generates cash flows incremental to the stable cash flows discussed above. Even using a 4x cash flow multiple for this more volatile earnings stream suggests an additional $15 of value per share for every $25 change in nitrogen price above the cost floor. Finally, Third Point believes that executing the remaining $2.25 billion of CF's share buyback authorization could be ~20% accretive to the estimates detailed above. CF has been underperforming recently despite the emergence of several positive indicators, including reduced Chinese plant operating rates, reports of capacity idling in Eastern Europe, and the shelving of two plant expansions in North America. This underperformance reinforces Third Point's view that a dividend strategy based on CF's stable cash flow stream would lead investors to reassess the company's valuation.

On October 17, **Barington Capital** announced that they represent a group of shareholders that owns over 2% of the outstanding common stock of **Darden Restaurants, Inc.(DRI)** and sent a letter to the Board on September 23, 2013 making recommendations to improve the financial and share price performance of the Company. Barington points out in their letter that while the Company has outperformed its peers between 1999 and 2008, it has performed poorly against its peers since then. Barington's recommendations include: (i) forming two independently managed restaurant operating companies – one for Darden's mature brands (Olive Garden and Red Lobster) and one for its higher-growth brands (LongHorn Steakhouse, The Capital Grille, Yard House, Bahama Breeze, Seasons 52 and Eddie V's Prime Seafood); (ii) exploring all alternatives to monetize the value of the Company's real estate assets, including the creation of a publicly traded real estate investment trust (REIT); and (iii) reducing operating expenses by bringing Darden's cost structure in line with the Company's better performing peers. Barington cites McDonalds, Brinker international (Chili's) and Lone Star Funds (Del

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Friscos) as three companies that have divested non-core brands resulting in the creation of significant shareholder value. Barington also states that Darden owns more real estate than its peers and estimates its real estate assets are worth approximately $4.2 billion. Moreover, Barington believes the Company can reduce its operating expenses by $100 - $150 million per year. Barington believes that if its first two suggestions are fully implemented, Darden's common stock would trade between $69 and $76 per share without taking into consideration any positive impact of operating improvements or further reduction in operating expenses.

In August, **Trian** disclosed that it owned 21 million shares of **DuPont Co.** (valued at $1.25 billion). Trian had met with Chairman/CEO Ellen Kullman and other senior managers to talk about their ideas outlined in a white paper. It was predicted that Trian was proposing breaking DuPont into two companies, one focused on its agriculture business and the other focused on materials. On October 24, it was announced that DuPont was splitting in two, spinning off its performance chemicals segment into a new publicly traded company. The unit — which makes a pigment that turns paints, paper and plastics white, as well as refrigerants and polymers for cables — generated about $7 billion in revenue in 2012. DuPont had announced in July, prior to Trian's involvement, that it would explore "strategic alternatives" for the unit and stated that its decision came after a thorough strategic review process over the last year. DuPont expects the spinoff to be completed in about 18 months, and said it would be tax-free to shareholders, who will receive stock in the new company. The DuPont that remains will have three main areas of focus, each trying to make products that address global population growth. Its agriculture business will develop and produce seeds and herbicides aimed at increasing crop yields around the globe. A bioindustrials unit will be involved in the production of biofuels in an effort to reduce the world's reliance on fossil fuels. And an advanced materials segment will make components for green buildings and solar panels, as well as products like Kevlar.

On January 29, **Elliott Associates** announced that they own 4.0% of the common stock of **Hess Corp (HES)** and were nominating a slate of the following five independent directors to the Company's 14 person Board: (i) Rodney F. Chase - Former Deputy Chief Executive, BP plc; (ii) Harvey Golub - Former Chief Executive Officer, American Express Company; (iii) Karl F. Kurz - Former Chief Operating Officer, Anadarko Petroleum Corporation; (iv) David McManus - Former Executive Vice President, Pioneer Natural Resources Company; and (v) Marshall D. Smith - Chief Financial Officer, Ultra Petroleum Corporation. Upon receipt of notification of Elliott's intention to nominate directors, Hess announced an exit from its refining and terminal business. Elliott views this as a minor step and believes that the strategic, capital, organizational and corporate governance problems at the Company go much deeper, and Hess needs to address the larger problem. Elliott concludes that Hess requires a thorough restructuring that realigns its current multitude of businesses and assets into manageable, focused enterprises. Elliott believes that the appropriate board unlocking value could lead to a share price of at least $126. To that end, they believe the Hess board should: (i) spin off the Bakken along with the Eagle Ford and Utica acreage; (ii) divest downstream assets and monetize resource play infrastructure; and (iii) streamline the remaining international portfolio. On May 16, 2013, Elliott and Hess entered into an agreement to resolve Elliott's proxy contest. Pursuant to the agreement, Elliott agreed to withdraw its slate of five director nominees and support the election of Hess' five new directors. Three of Elliott's director nominees, Chase, Golub, and McManus were added to the 2015 director class, to for a 14-person reconstituted Board.

On April 22, 2013 at our Fourth Annual Active – Passive Investor Summit, **Jeff Ubben** of **ValueAct Capital** disclosed that ValueAct had made a $2 billion investment in **Microsoft Corporation**. Jeff made a very compelling and detailed presentation. He said that like Adobe, Microsoft suffered from a divergence of perception and reality. ValueAct thinks Microsoft is a company that is perceived to not be able to win consumers, dying with PCs, losing out to Google and irrelevant in the Cloud world. In reality, ValueAct believes Microsoft is an enterprise company with software businesses that users value, resulting in a growing recurring revenue base. Moreover, ValueAct believes that Office 365 may be a game changer and Microsoft is well positioned for the hybrid cloud world. On August 30, 2013, Microsoft and ValueAct entered into a cooperation agreement providing for regular meetings between Mason Morfit, President of ValueAct, and selected Microsoft

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directors and management to discuss a range of significant business issues. The agreement also gave ValueAct the option of having Morfit join the Microsoft board of directors beginning at the first quarterly board meeting after the 2013 Annual Meeting, which will take place on November 19, 2013.

On April 19, 2013 **Trian** unveiled its stake in **Mondelez Int'l** Inc. in an amended 13F filing, along with a stake in PepsiCo. At a conference in July, Peltz said that Pepsi should acquire Mondelez and then spin off the soft drink business altogether. He also stated that Pepsi should spin off its Frito Lay unit, if it doesn't want to acquire Mondelez. On October 29, at a conference in Chicago, Peltz stated his belief that Mondelez is poorly run despite its catalog of great brands (i.e. Oreo, Trident and Cadbury). Peltz argued that the cost structure is inflated compared to peers and operating margins are not as high as they could be with a touch of operational improvements. Peltz would also like to see the Company shed its name because it sounds too much like a medicine.

In May of 2013, **Elliott Management Corp**. took a 4.5% stake in **NetApp Inc. (NTAP)**, pressing the data-storage company to change its board and study options to boost shareholder value, including a return of cash to shareholders. Elliott had suggested potential director candidates and it is also noteworthy that NetApp has been viewed as a takeover target for about a decade, with Oracle Corp. (ORCL) and Cisco Systems Inc. (CSCO) cited as potential buyers. NetApp has $5 billion of cash and less than $1 billion of debt versus almost $900 million of EBITDA. In July of 2013, NetApp announced that it planned to add two directors to its board. NetApp disclosed that it will seat Kathryn M. Hill and Tor R. Braham as its newest directors, both of whom have been involved in the technology sector for a long time and suggested by Elliott Management. Ms. Hill was most recently a senior vice president of development strategy and operations at Cisco Systems. And Mr. Braham is a longtime technology mergers banker who previously worked at Deutsche Bank and at Credit Suisse. A possible goal of adding the two directors is to help steer the company's board into considering a sale, an idea that Elliott has supported. The Company has already taken steps to return money to shareholders. In May, it rolled out a $3 billion stock buyback plan and a new quarterly cash dividend.

Third Point purchased following the announced sale of its Devices and Services ("D&S") business to Microsoft for €5.44 billion in an all-cash transaction. Expected to close in Q1 2014, the deal provides €3.8 billion for the D&S business and €1.6 billion for a 10-year non-exclusive patent licensing agreement. Once the transaction is complete, "new" **Nokia** will consist of the Nokia Siemens Networks ("NSN"), the HERE maps business, and a patent portfolio known as Advanced Technologies. The Company will have approximately €8 billion of net cash when the transaction closes, and Third Point expects a meaningful portion of the excess will be distributed to shareholders in coming quarters. Either a buyback or a special dividend is possible. The de facto spin off of the D&S business leaves Nokia with a significantly different strategic and operational profile, with 40% of today's market capitalization reflected in pro forma net cash and a portfolio of three distinct businesses each generating positive free cash flow. Third Point believes that each of Nokia's businesses has interesting opportunities and dynamics. In the case of NSN, years of restructuring have resulted in a more profitable business, while the market structure has improved following years of consolidation ahead of a global 4G upgrade cycle. Having acquired Siemens' 50% stake in NSN this summer at a very attractive valuation, Nokia now has greater control over the operating and strategic prospects for the business. The HERE maps business has exceptional share in the built-in automotive navigation market (estimated at 80 – 90%) along with significant potential in portable navigation, an increasingly strategic area for smartphone vendors. The Advanced Technologies intellectual property licensing business has historically operated on a net basis in commercial agreements with other smartphone vendors. Going forward, Nokia has the opportunity to realize royalty revenues on a gross basis and focus on a broader licensing program of its 10,000 patent families, which include leadership positions in 2G/3G/4G standard essential patents, as well as a broad array of non-standard essential patents. Nokia's patent portfolio has been successfully defended in court and via settlement agreements over the years, enhancing its licensing prospects and strategic value. For years, the investment case for Nokia has centered on the prospects for the handset business with little emphasis on NSN, the maps business or the intellectual property licensing opportunity. Third Point thinks the repositioning of the "new" Nokia story will take time for the broader investment community to absorb. the prospect of a substantial one-time capital return and possible

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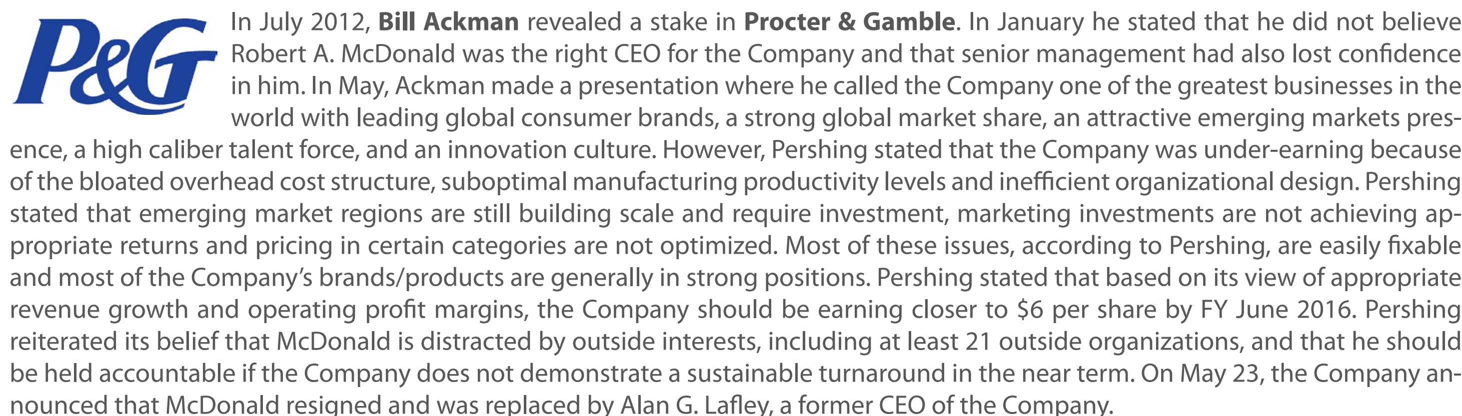
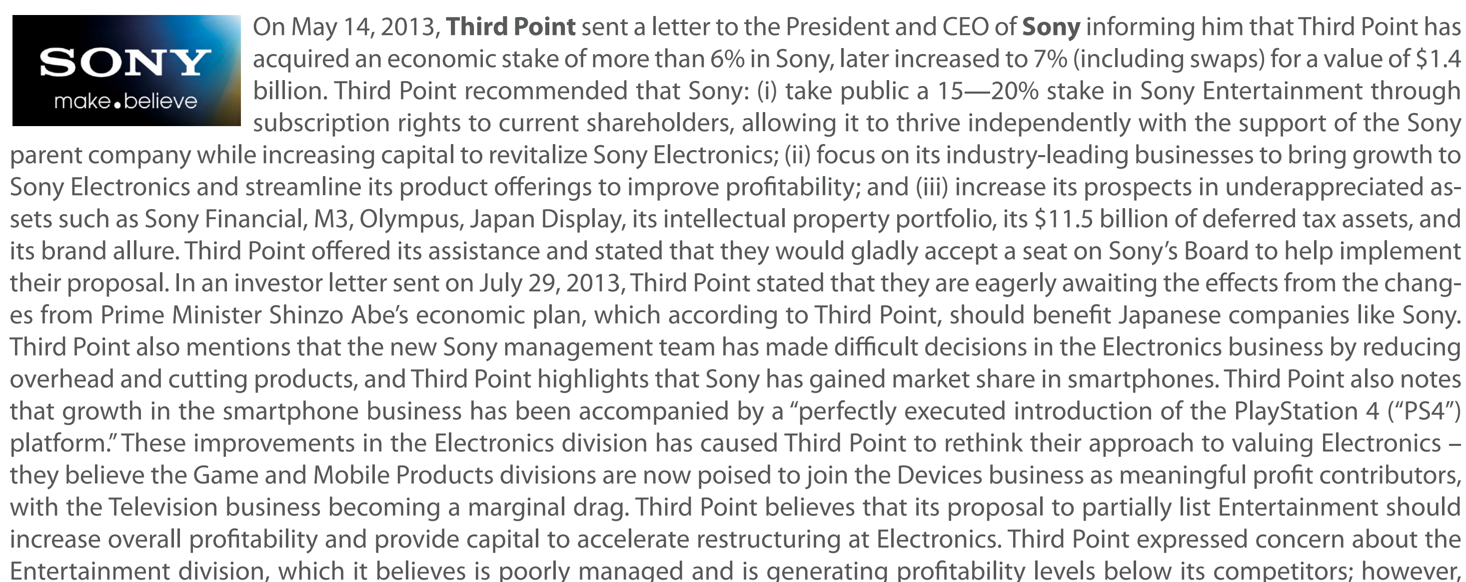
reinstatement of a regular dividend further enhances the upside potential and Nokia's commitment to return excess capital and the attractive price paid for Siemens' 50% stake in NSN suggest Nokia's leadership will remain prudent in capital allocation decisions going forward.

On July 17, **Trian Fund Management's Nelson Peltz** said that **Pepsi** should acquire the snack maker Mondelez. Trian is a big shareholder of both companies. Peltz said Pepsi should buy Mondelez and then spin off the soft drink business altogether. He argued that consumer tastes are turning against soft drinks. Peltz also said that if Pepsi doesn't want to acquire Mondelez, it should spin off its Frito Lay unit. Peltz said that the problem with Pepsi has not been management, but structure and that he would be meeting with Pepsi's management to discuss the proposal "in the very near future." Following this disclosure, Pepsi said it had held talks with the hedge fund to "consider their ideas." A day after Peltz revealed his strategy, one of Pepsi's largest shareholder, Blackrock Inc., publicly stated that it opposed Nelson Peltz's proposal. A week later after announcing a better-than-expected second-quarter profit, Pepsi CEO Indra Nooyi effectively dismissed Peltz's idea. Pepsi CFO Hugh Johnston took it one step further, saying: "You'll hear people occasionally advocate for that type of transaction," Johnston said. "The thing that they really need to look at is what's their percentage holdings of Mondelez and what's their percentage holdings of PepsiCo."



In July 2012, **Bill Ackman** revealed a stake in **Procter & Gamble**. In January he stated that he did not believe Robert A. McDonald was the right CEO for the Company and that senior management had also lost confidence in him. In May, Ackman made a presentation where he called the Company one of the greatest businesses in the world with leading global consumer brands, a strong global market share, an attractive emerging markets presence, a high caliber talent force, and an innovation culture. However, Pershing stated that the Company was under-earning because of the bloated overhead cost structure, suboptimal manufacturing productivity levels and inefficient organizational design. Pershing stated that emerging market regions are still building scale and require investment, marketing investments are not achieving appropriate returns and pricing in certain categories are not optimized. Most of these issues, according to Pershing, are easily fixable and most of the Company's brands/products are generally in strong positions. Pershing stated that based on its view of appropriate revenue growth and operating profit margins, the Company should be earning closer to $6 per share by FY June 2016. Pershing reiterated its belief that McDonald is distracted by outside interests, including at least 21 outside organizations, and that he should be held accountable if the Company does not demonstrate a sustainable turnaround in the near term. On May 23, the Company announced that McDonald resigned and was replaced by Alan G. Lafley, a former CEO of the Company.



On May 14, 2013, **Third Point** sent a letter to the President and CEO of **Sony** informing him that Third Point has acquired an economic stake of more than 6% in Sony, later increased to 7% (including swaps) for a value of $1.4 billion. Third Point recommended that Sony: (i) take public a 15—20% stake in Sony Entertainment through subscription rights to current shareholders, allowing it to thrive independently with the support of the Sony parent company while increasing capital to revitalize Sony Electronics; (ii) focus on its industry-leading businesses to bring growth to Sony Electronics and streamline its product offerings to improve profitability; and (iii) increase its prospects in underappreciated assets such as Sony Financial, M3, Olympus, Japan Display, its intellectual property portfolio, its $11.5 billion of deferred tax assets, and its brand allure. Third Point offered its assistance and stated that they would gladly accept a seat on Sony's Board to help implement their proposal. In an investor letter sent on July 29, 2013, Third Point stated that they are eagerly awaiting the effects from the changes from Prime Minister Shinzo Abe's economic plan, which according to Third Point, should benefit Japanese companies like Sony. Third Point also mentions that the new Sony management team has made difficult decisions in the Electronics business by reducing overhead and cutting products, and Third Point highlights that Sony has gained market share in smartphones. Third Point also notes that growth in the smartphone business has been accompanied by a "perfectly executed introduction of the PlayStation 4 ("PS4") platform." These improvements in the Electronics division has caused Third Point to rethink their approach to valuing Electronics – they believe the Game and Mobile Products divisions are now poised to join the Devices business as meaningful profit contributors, with the Television business becoming a marginal drag. Third Point believes that its proposal to partially list Entertainment should increase overall profitability and provide capital to accelerate restructuring at Electronics. Third Point expressed concern about the Entertainment division, which it believes is poorly managed and is generating profitability levels below its competitors; however,

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Third Point states its research has revealed Entertainment's hidden value in the film business and meaningful value in the Music division, particularly in VEVO and GraceNote. Third Point would like to see a revived Electronics combined with a well-managed, publicly-listed Entertainment business, and believes it would make for a stronger Sony and offer tremendous value for shareholders.

On May 16, **Sandell Asset Management** sent a white paper to **Spectra Energy ("SE")** outlining their goal to transform Spectra Energy from a Utility to an Infrastructure Player. Sandell estimates that the valuation of SE would be between $41 and $48 if the Company were to take the following steps: (i) Drop-down SE's US Transmission assets into an MLP; (ii) IPO/Sell SE's Canadian operations, a fully-owned subsidiary operating as Westcoast Energy Inc.; and (iii) IPO/Sell SE's 50% stake in DCP Midstream LLC to highlight DCP's MLPqualifying income. Sandell says that these steps will better align shareholder bases to assets, reducing SE's conglomerate discount thereby lowering cost of capital and tie management incentives more directly to operational performance of assets and strategy. Sandell points out that over the past year, SE has traded down 5% versus comps which were up 21% - a 26% underperformance and over a 3 year period, SE's under-performance has been much more dramatic – 72% below comps. Sandell estimates that dropping down SE's US Transmission assets yields SE value of $20-$21/share and uses as a case study Williams Companies dropping down all of its midstream and pipeline assets into Williams Partners in January 2010. Sandell estimates that the IPO of Westcoast Energy will highlight its $14 to $16/share value based on trading multiples for comparable Canadian infrastructure companies. Finally, Sandell estimates that the IPO/Sale of DCP Midstream yields $7/share, plus an additional $4/share from normalization of natural gas and NGL prices. On June 11, the Company announced that it will be dropping down all of its US Transmission and Storage Assets into an MLP. As far as Sandell is concerned, this is a great start but there is a lot more that can be done, which they conveyed to management on June 12. Then, on June 17, Sandell sent a public letter to the Company applauding their decision to drop the assets into an MLP, but urged them to pursue the additional steps that Sandell outlined in its white paper and to implement operational cost cuts across SE's entities that will reduce inefficiencies and boost profitability as management teams are more aligned with underlying operating asset performance and their related publicly-traded shares. Sandell further points out that the Company's CEO compensation has been consistently ranked at the top amongst CEOs of the same peer group despite a significant underperformance to the peer group, demonstrating a complete lack of alignment between executive compensation and shareholder returns. Sandell speculates that it is both this lack of alignment and the CEO's beneficial ownership of only 0.04% of shares outstanding that explains why SE has not engaged in all the actions its peers have already taken – the glaring absence of financial motivation for the CEO to do so. Sandell ends the letter by informing the Company that they have formed a shareholder group and are now one of the Company's largest shareholders. The Group intends to continue to promote change at SE for the benefit of all of its shareholders. They would like to work collaboratively with the Company but should the Company fail to promptly take all the steps to maximize shareholder value as Sandell has outlined in its white paper, they intend to pursue a change to the composition of the Board at the next annual meeting. The deadline to nominate directors is January 30, 2014.

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IMN
Active-Passive Investor Summit
Top Activist Investors will present their best investment ideas.
Early Confirmed Speakers Include:

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New Filings for November

Company Name	Investor	Mkt. Cap.	Filing Date	%	Cost	Item 4 Action
Volcano Corp. (VOLC)	Engaged	$1.03B	11/4/13	5.10%	$21.52	enhance shareholder value
Men's Wearhouse (MW)	Eminence	$2.17B	11/7/13	9.80%	$41.75	explore alternatives
Riverbed Technology (RVBD)	Elliott	$2.45B	11/8/13	9.00%	$15.15	enhance shareholder value
Allison Transmission (ALSN)	ValueAct	$4.78B	11/13/13	9.90%	n/a	n/a
Freddie Mac (FMCC)	Pershing Square	$1.89B	11/15/13	9.77%	$2.14	n/a
Fannie Mae (FNMA)	Pershing Square	$3.86B	11/15/13	9.98%	$2.29	n/a
Hologic Inc. (HOLX)	Carl Icahn	$6.03B	11/21/13	12.63%	$21.36	possible board representation

One to Watch

Company

Allison Transmission Holdings (ALSN)
Market Cap.: $4.78B ($26.20/share)
Enterprise Value: $7.32B
Cash: $152.30M
Debt: $2.73B
EBITDA: $582.60M

Investor

ValueAct Capital
13F Holdings: $11.08B
# of 13F Positions: 14
Largest Position: $2.23B
Avg. Return on 13Ds: 58.99%
Versus S&P500 avg: 8.36%

Investment

Date of 13D: 11/13/13
Beneficial Ownership: 9.90%
Average Cost: n/a
Amount Invested: $473.05M
Highest price paid: $23.25
# of larger shareholders: 2

ValueAct Capital is a "governance-oriented investor" and historically has been on the boards of approximately half of the companies in its portfolio. While ValueAct is active in many of its portfolio companies, it files 13Ds in all of its 5% positions (as opposed to passive 13Gs), regardless of its intended level of involvement. In half of its companies, it will support management from afar and in the other half they will get on the Board because they feel it is needed. While ValueAct is rarely confrontational and generally supportive of management, this situation is even more so amicable. Carlyle Group and Onex Corporation own a combined 61.4% of the Company as the sponsors of a 2007 LBO. So, ValueAct's filing indicates confidence in the sponsor and in management. This is a typical ValueAct investment, good company with stable cash flow and upside growth opportunities, particularly where the Company is in the cycle. Due to decades worth of tax advantages, ALSN offers a 10% after tax cash yield. ALSN is a provider of premium automatic transmissions for the trucking market. ALSN has had some disappointing top line results due to growth prospects in China not panning out, soft fracking and mining markets and military budget cuts, among other things. The international growth opportunity still exists, particularly as trucks continue to convert from manual to automatic transmissions. Also, there are many potential domestic tailwinds due to being at or near the bottom of many cycles, such as an increase in long term fracking and mining needs, increased military and municipal expenditures, increased construction spending and an economic pickup leading to demand for more commercial trucks. So the opportunities here are: (i) revenue growth, (ii) use ample cash flow to pay down debt and return cash to shareholders, and (iii) better multiple as LBO sponsors continue to sell shares (they recently sold 15 million shares) and liquidity increases.

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Activist/Activist Defense Directory

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