



Knocking on the door – Shareholder activism in Europe: Five things you need to know

J.P.Morgan

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I. Introduction

Shareholder activism has seen a strong resurgence since 2008, and is currently approaching the historic levels seen prior to the financial crisis.

This is the case not only in the U.S., which has long been the nexus of shareholder activism and where activism is now a well-established and accepted phenomenon, but also increasingly in markets outside of the U.S., particularly in Europe.

40% of activist hedge funds globally have either a European or global investment focus¹

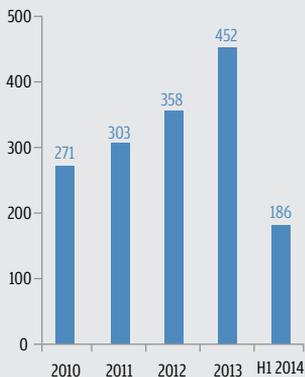
The increased size of activist funds and their successful track record have created a virtuous circle that has allowed activist investors to target larger corporations in which to invest, continually making headlines in the financial press over the past couple of years. See page three for further details.

The rise in assets under management also means that there is more activist capital chasing a limited number of opportunities in the U.S., which has helped to drive the increased activity in Europe.

Furthermore, the post-crisis capital markets and corporate environment are increasingly conducive to activist campaigns as it is easier for activist funds to identify candidates where there is perceived value to unlock.

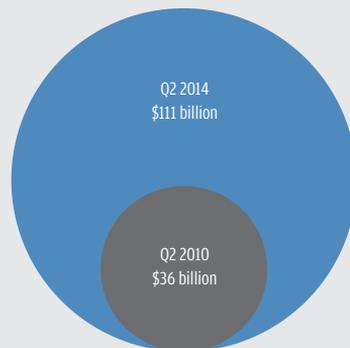
27 publicly initiated activist campaigns in Europe in H1 2014²

The number of investments made by activists globally (publicly disclosed) saw a 26% increase from 2012 to 2013



Source: Activist Insight, June 2014

Strong performance by event-driven funds has propelled a 33% YOY increase in assets under management



Source: THFR Industry Reports © HFR, Inc., July 2014

¹ Source: Preqin Hedge Fund Analyst, June 2014

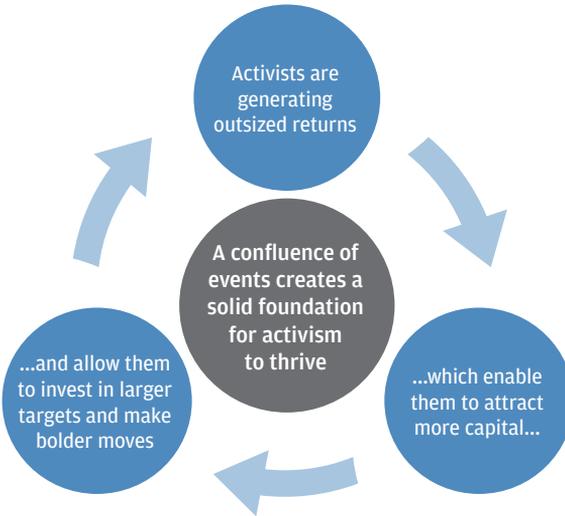
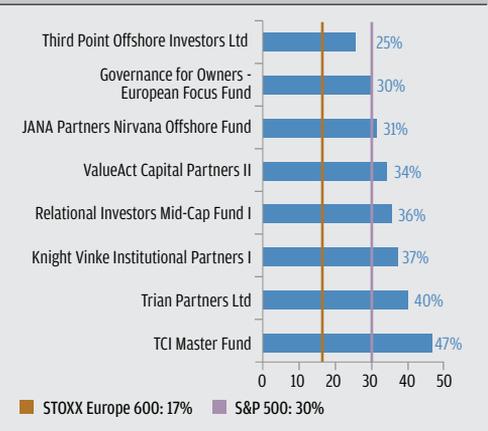
² Source: J.P. Morgan European activism database, July 2014

The virtuous activism investment circle

As investors search for returns, event-driven funds and activists in particular are attracting capital. General attraction to activism is grounded in the belief that event-driven strategies can be a source of idiosyncratic returns as corporate events tend to be uncorrelated to general economic conditions. Several high-profile instances of success for activists have served to draw further attention to this particular investment strategy.

The ability for activists to generate returns in excess of benchmarks has been demonstrated, which also continues to attract more capital.

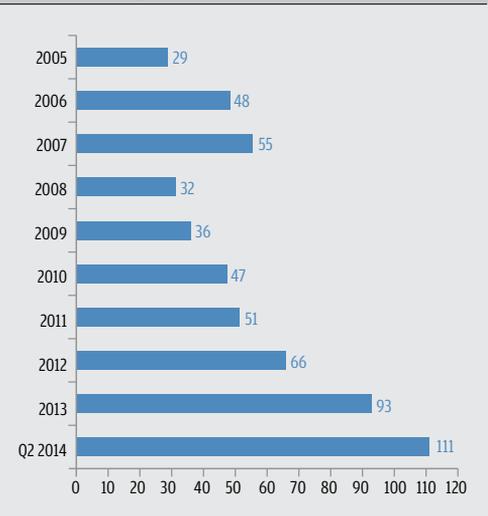
Strong investor sentiment: Selected 2013 activist funds returns (%)



With more capital to deploy, activists are going after larger targets than ever before and are waging bigger bets on any given investment:

- Even the largest corporates are now vulnerable; for example, Apple, Microsoft, Dow and PepsiCo have each been subject to public activist investments in the recent past
- Activists are investing in larger campaigns across corporates of all sizes, resulting in more diverse and bold tactics, such as bidding for entire companies, either alone or in partnership with a strategic buyer
- However, it is important to note that gaining credibility and influence can be achieved with a relatively small stake, as witnessed in Bill Ackman’s campaign at P&G and Knight Vinke at UBS.

Growing activist funds under management \$bn (dedicated money only, excludes multi-strategy)



II. Five things you need to know about shareholder activism in Europe

1. What is driving the current resurgence in activism?

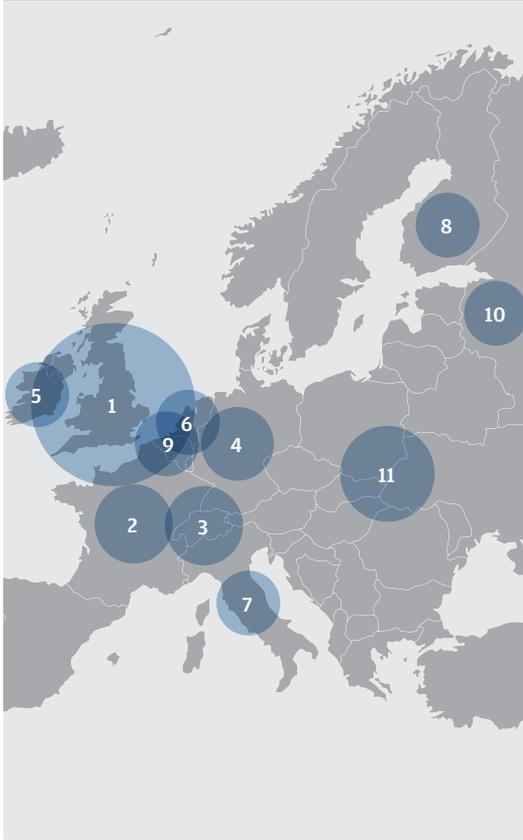
Market and economic conditions, coupled with an increase in M&A, have driven the resurgence of activism.

Key global drivers include:

- Record levels of cash on company balance sheets coupled with access to historically low-cost debt financing.
- Companies and boards are no longer in survival mode in the post-financial crisis era and are increasingly looking at growth and value creation.
- The lack of top-line growth has investors increasingly focused on corporate clarity and catalysts for shareholder value creation such as distribution policy, operational improvements and corporate strategy.
- Since 2009, the recovery in equity markets and the concomitant upsurge in both strategic and private-equity-backed M&A have emboldened activists to press companies to merge, acquire, be acquired, or divest or spin-off non-core subsidiaries.
- Investors and the media are less tolerant of what they perceive as poor governance, with additional scrutiny prompted by executive remuneration.

Historically, the European market was considered structurally less attractive for activists than the U.S. Today, however, they have adjusted their tactics and are exploring new territories.

- **A highly fragmented market:** Europe is defined by a myriad of local regulations, overlaid with EU directives and local stock market rules
- **New exceptions to the rule:** Significant insider ownership by families and governments, as well as cross-shareholdings, which are more prevalent in Continental Europe, have tended to keep activist prominence subdued amongst large companies. However, recent exceptions to this include Knight Vinke's campaign at **ENI** (Italy), The Children's Investment Fund's campaign at **Airbus** (France) and Findim Holdings campaign at **Telecom Italia** (Italy)
- **The equity landscape:** Some of the Continental European stock markets are viewed to be less liquid, which can pose an innate hurdle to building a meaningful undetected stake, and then subsequently, being able to exit a position
- **A fertile economic environment:** Activity tends to track the health of the stock market and, in turn, the broader economy, which in Europe has generally lagged behind the U.S. recovery, but is now seeing emerging signs of renewed growth

Heatmap: Primary geographies for activist activity in Europe (2010-Q2 2014), publicly disclosed


While the jurisdictions below have seen the most activity, there are early indications that activists alongside other investors are looking at Southern Europe with increasing interest. For example, there have been five campaigns in Italy since 2013, and activist investor Amber Capital recently launched a new \$350 million fund in December 2013 focused on Southern Europe.

Country	No. of campaigns	% of total European activity
1 United Kingdom	103	43.1%
2 France	26	10.9%
3 Switzerland	20	8.4%
4 Germany	16	6.7%
5 Ireland	9	3.8%
6 Netherlands	8	3.3%
7 Italy	8	3.3%
8 Finland	7	2.9%
9 Belgium	6	2.5%
10 Russia	6	2.5%
11 Rest of Europe	30	12.6%

Source: J.P. Morgan European activism database, July 2014

Recent selected activist campaigns in Europe

Target	Activist investor	Stake ¹	Country	Sector	Objective	Outcome	Date
InterContinental Hotels Group	Marcato Capital Management	3.88%	UK	Hotels/Resorts	Sale of the company	Ongoing	May-14
Volvo	Cevian Capital	12.7%	Sweden	Industrials	Dispose of division	Ongoing, pushing for board seat	Jan-14
FirstGroup	Sandell Castlerigg Investment	3.1%	UK	Transport	Refocus business	Ongoing	Dec-13
Airbus	The Children's Investment Fund	1.0% ²	France	Industrials	Dividend stake in subsidiary to shareholders	Successful	Aug-13
Netia	Third Avenue Management	16.6% ³	Poland	Telecoms	Sale of the company	Unsuccessful, obtained board seat	Aug-13

Source: J.P. Morgan European activism database

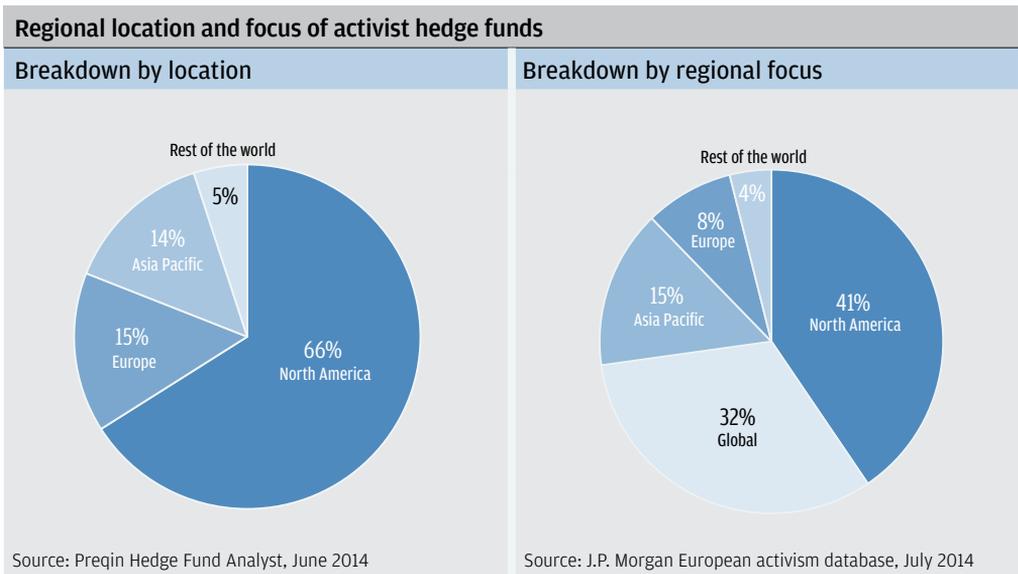
¹ Publicly disclosed data as of the date of this publication

² Reuters, 5 August 2013, article "Activist fund TCI asks EADS to sell Dassault stake"

³ Third Avenue Management announced in November 2013 that it held a 16.6% stake, and exited its last 12.7% holding in May 2014

2. Who are the predominant activists in Europe?

- Beyond location, location, location:** While today the majority of activist hedge funds are headquartered in North America, Europe is a key regional investment focus, targeted by 40% of activist hedge funds when considering funds that have either a European or global investment focus (see below for further breakdowns)
- Rising investor expectations:** The aforementioned confluence of events (see page five), which has led to more funds with more capital pursuing an activist investment strategy, has resulted in increasing pressure for activist funds to find unique opportunities to generate the outsized returns their investors have come to expect. This is considered to be fuelling an increased interest in Europe as fertile ground to deploy capital with an activist strategy
- The less travelled ground:** 21% of all hedge fund managers are located in Europe (covering all hedge fund strategies) relative to the 15% of total activist funds that are based in the region, signalling a potential under-representation of activist hedge funds in Europe, which further supports the expectation that activity in Europe should be on the rise



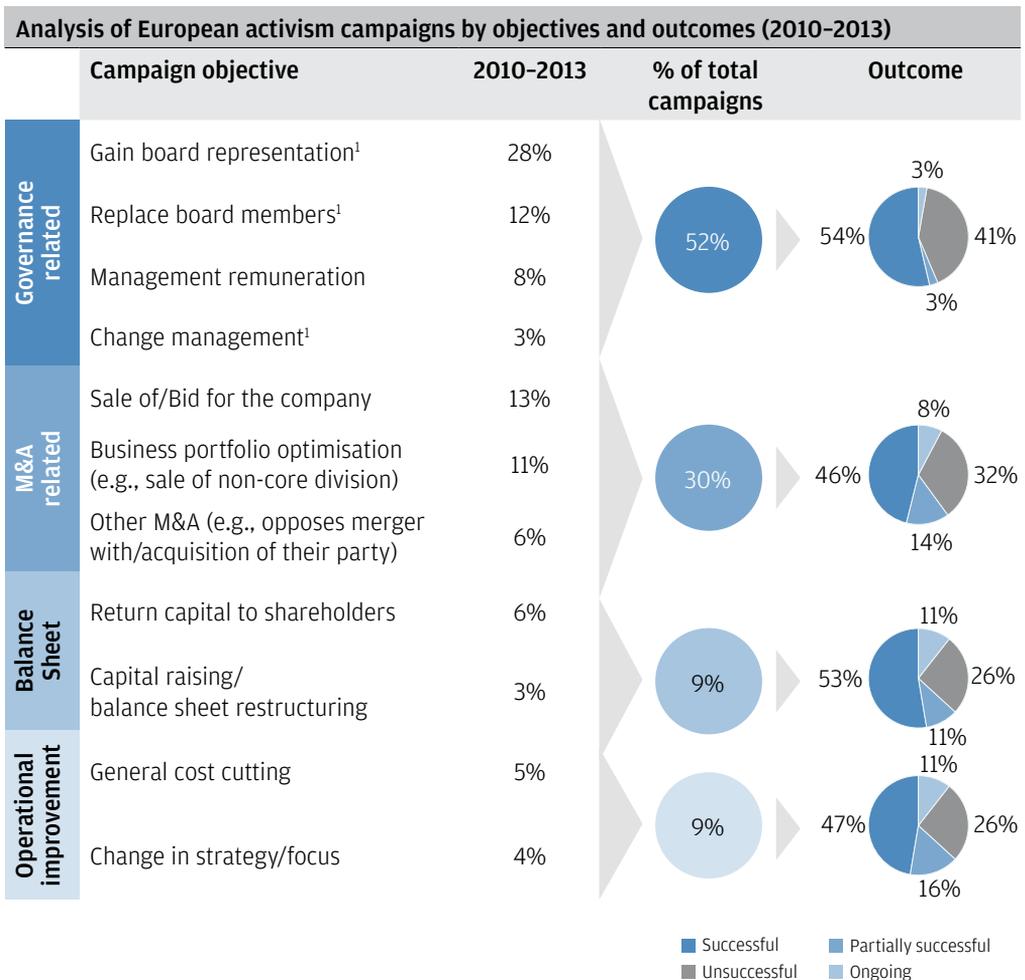
Prominent activists in Europe based on recent public campaign history				
Activist investor	Fund HQ	Cumulative target value since 2010 (\$mm) ¹	No. of campaigns (since 2010)	AUM (\$mm)
Cevian Capital	Europe	105,183	15	9,000
Crystal Amber Fund	Europe	2,079	14	200
Knight Vinke	Europe	473,978	13	1,171
Elliott	U.S.	61,025	11	23,000
Weiss Asset Management	U.S.	815	8	1,197
Triam Partners	U.S.	111,413	7	5,000
The Children's Investment Fund	Europe	136,923	6	12,000
Icahn Enterprises	U.S.	114,618	6	20,000
GO Investment Partners	Europe	7,729	5	1,290
Amber Capital	U.S.	28,730	4	2,068
Third Point	U.S.	34,722	3	14,000
Jana	U.S.	11,408	2	5,455
RWC Partners	Europe	534	2	8,806

Source: J.P. Morgan European activism database, July 2014

¹ Sum of market capitalisation of each activist target at time of announcement of campaign; a target might be included more than once in the case of multiple instances of activism

3. What are the primary objectives of shareholder activism?

- There are a number of attributes that are likely to attract activism, such as relative underperformance, change in strategic direction, capital allocation, balance sheets and returns policies, and corporate governance
- Governance-related campaigns often belie some other motive the particular activist shareholder may have in waging a campaign against a company's board
- In line with the trend seen in the U.S., approximately half the time, activists typically get what they set out to achieve. However, this is not an indicator of whether their initiatives or campaigns have led to value creation
- Only a limited number of activists will target operational matters, and typically only where they have particular insights or industry experience



Source: J.P. Morgan European activism database, July 2014

¹ Normally the result of operational, balance sheet and M&A related considerations

4. What tactics do activists use?

- Particularly in Europe, more vocal or active shareholders position themselves as “constructivists” rather than activists
- Activists often work with, and proactively seek, the approval and support of long-only funds, who themselves are less likely to voice a contrary position to company management

*~50% of European activism is estimated to never enter the public domain**

Type of activist	Typical tactics
Benign/Moderate	<ul style="list-style-type: none"> • Interview customers, shareholders and line management • Contract with or hire former employees and/or experts in sector to underpin investment thesis • Request to meet management (may be part of ordinary course investor roadshow) • Encourage other hedge funds to enter stock • Private letter to the Board
More aggressive	<ul style="list-style-type: none"> • Accumulate stake through disclosure threshold (may or may not make public comment) • Publicly advance agenda <ul style="list-style-type: none"> - Open letter to the board - Pursue campaign ideas with research analyst community and media - Media interviews/tweets • Form committee/alliance with other shareholders • Shareholder proposals at the annual general meeting
Hostile	<ul style="list-style-type: none"> • Present detailed proposal in a “white paper” • Demand seat on board • Public relations battle and/or proxy fight to replace board and/or management • Solicit buyers for all or part of business • Public bear hug/Tender offer

*Source: J.P. Morgan

5. How can you prepare for activism?

Simply ignoring an activist shareholder may only exacerbate the situation. The board and management may come under the microscope and potentially under attack. Events can often move very quickly with every step played out in the media once a campaign becomes public. Balanced, constructive and proactive engagement is critical to arrive at an acceptable outcome, and is increasingly becoming the approach U.S. companies are taking towards activists.

“Ignoring an approach often signals weakness, activists feed on long-only concerns and when there’s reluctance to engage with them they stand to attention.”

- Hernan Cristerna, Global Co-Head of M&A

Some preparedness considerations include:

- Be alert to concerns from long-only investors
- Monitor your performance relative to your peers
- Identify previous tactics employed by activists
- Review your strategy and financial plan through their eyes. Analyse against their objectives, whether it be strategy, capital structure or governance related in order to deliver a tailored, compelling response framework
- Track peer activity on these metrics
- Routinely assess external messaging and communications across multiple stakeholder groups, including employees, sell-side analysts and the media
- Engage shareholders and solidify support
- Construct a comprehensive response team comprised of internal and external experts

While there is a genuine debate around the long-term impacts of activism, the near- to medium-term returns activists appear to generate for their investors have attracted increased public attention and financial capital. The expectation is that shareholder activism will continue to grow, so it is critically important to be prepared.

For a tailored scenario analysis or further information please contact your J.P. Morgan representative.

III. About our M&A team

We advise corporations and institutions of all sizes on their most complex strategic needs, in their home markets and around the world.

Drawing upon a proven track record of more than 7,500 M&A transactions*, clients benefit from bespoke solutions combining:

- In-depth knowledge of sector and market dynamics with M&A bankers based locally in every major market globally
- Innovative advice on valuation, transaction structures and deal tactics/negotiations
- Rigorous execution delivered with responsive and agile service
- Comprehensive financing through our debt and equity issuance platforms
- Ability to partner with product experts where appropriate across our full range of competencies (derivatives, treasury services, including escrow services, and other areas of expertise)

J.P. Morgan provides M&A advisory solutions across the full strategic lifecycle of our clients:

Strategic expansion

- Acquisitions including cross border opportunities
- Mergers and joint ventures

Enhancing business value

- Sales transactions
- Divestures
- Capital restructuring projects
- Spin-offs and other restructurings

Shareholder strategy

- Defence preparedness for publicly announced and non-public approaches
- Dedicated shareholder activism advice

*Dealogic data based on announced transactions since 1995

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