Shareholder Activism in Australia
Navigating the evolving landscape

J.P. Morgan
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1. Executive summary: The rise — and spread — of global activism

Historically, the U.S. has been the primary focus of international activism activity, constituting nearly 80% of annual campaigns as recently as 2011. However, the number of international companies targeted by activist campaigns has significantly increased, alongside a rise in overall activism activity. **2015 saw new peaks in campaign volume, not only in the U.S., but also in Europe, Asia and Australia — where year-over-year activity grew by 63%, 37% and 8%, respectively.**

The growth in international activism continues to close the gap with U.S. activity, as the latter has begun to level off in volume following years of consistent growth. In 2016, international campaign activity surpassed 2015’s record, with 296 campaigns recorded. International activism is expected to increase and evolve, reminiscent of the strategy’s evolution in the U.S., where it outperformed as an asset class in the years following the global financial crisis. Of the more than 1,500 campaigns launched against U.S. companies since 2011, 119 have targeted companies with market capitalization greater than US$10 billion, showing a sustained appetite for pursuing larger targets. Activists also have a record of success in the U.S., with 43% of all closed campaigns launched during 2016 resulting in board seats for the activist.

**Exhibit 1**

<table>
<thead>
<tr>
<th>Shareholder activism campaigns globallya</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>269</td>
</tr>
<tr>
<td>Internationalb</td>
<td>80</td>
</tr>
</tbody>
</table>

Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017.

a Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.
b Defined as Europe, Asia and Australia.

1 Defined as Europe, Asia and Australia.
2 Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.
3 Sources: FactSet, SharkRepellent as of Apr. 17, 2017.
The recent experience of U.S. companies serves as a model for geographies as they adjust locally to the strategy’s emergence, evolution and resilience. Bolstered by a global trend toward shareholder-friendly corporate governance reform, even the most reticent markets are being pushed in the direction of improved shareholder communications, investor engagement, and board independence and diversity. Activists in every region, and particularly in Asia Pacific, have leveraged new and revised regulation to address boards and management teams to agitate for board change, demand higher returns and to have a voice in corporate strategy matters.

With a growing number of emboldened domestic funds, experienced foreign activists looking for targets abroad, and institutional investors worldwide increasingly receptive to activist-style engagement, every region is now susceptible to shareholder activism.

Among international companies, those in Australia, in particular, find themselves increasingly on the radar for activists looking to expand their influence. Although a number of factors encourage the strategy’s growth in the region, there are proactive measures companies can take to identify and address potential areas of vulnerability. Section 3 of this report explores steps a company can employ to mitigate activist risk.
2. The expanding profile of Australian activism

Overview

The increase in Australian shareholder activism has been widely covered and explored by both mainstream and business media outlets. Such ongoing focus has solidified a higher profile for the strategy as it continues to develop and become a fixture of the Australian market. However, press coverage analyzes only those campaigns that become public. As is the case outside Australia, many activist campaigns in Australia likely resolve privately, a testament to the growing strength of the strategy, the activists themselves and the desire by companies to settle campaigns quickly.

Exhibit 2

<table>
<thead>
<tr>
<th>Shareholder activism campaigns in Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>28</td>
</tr>
</tbody>
</table>

Sources: SharkRepellent, Activist Insight, Mergermarket, press articles as of Apr. 17, 2017.
Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

Australia activism key takeaways

- A favorable legal and regulatory environment has set the stage for activism to take hold in Australia.
- Most shareholder activism in recent years has been driven by domestic activists, with rising support from Australia’s institutional investors.
- Activists have focused primarily on affecting board composition of Australian companies.
- Tactics used by activists in Australia increasingly mirror those employed by U.S. activist funds.
- Increasing success rates in recent years have provided momentum as domestic activists demonstrate their ability to secure, or at least partially secure, their objectives.
A highly favorable legal and regulatory environment for activists

A number of elements make Australia an opportune environment for activist investors, perhaps the most important one being its shareholder-friendly regulatory framework. In Australia, a shareholder owning 5% or more of a company has the right to:

- Requisition or convene a meeting
- Put forward resolutions to remove — with or without cause — and appoint directors
- Require the company to distribute a shareholder statement

The Corporations Act 2001 empowers activists seeking to effect changes to Australian boards, giving them a number of resources and levers to help facilitate their objective, while simultaneously placing companies on the defensive by allowing directors to be challenged at any point in time.

The ‘two-strikes’ rule

In July 2011, an amendment to the Corporations Act was enacted that provides a means for activists to hold boards accountable for executive compensation. This “two-strikes” rule provides shareholders the right to vote to spill the board if 25% or more of the votes cast at an annual general meeting, over two consecutive years, are against adopting the company’s remuneration report.

Through the “two-strikes” rule, activists can move for a board spill without calling for a meeting. For some dissidents, the rule has provided a means to signal dissatisfaction with the company, whether or not remuneration is a current issue or spilling the board is an immediate goal.

In order to be successful, the spill resolution requires a simple majority (i.e., more than 50%) of those eligible to vote to agree. Following the successful vote to spill, all directors (other than the managing director) must face re-election within 90 days.
Anatomy of Australian targets

Size

Historically, the vast majority of Australian corporates targeted by shareholder activists have been small-cap stocks. However, recent high-profile campaigns against blue-chip firms are signaling the intention of activists to pursue larger targets. Since 2014, 23 campaigns have launched against Australian companies with market capitalization greater than US$1 billion.5 As support from institutional investors solidifies and capital pours into the strategy, large-cap companies can increasingly expect to find themselves in the cross hairs of unsatisfied shareholders, a trend that mirrors the evolution of shareholder activism in the U.S.

Exhibit 3
Sector

Given the prevalence of natural resources in Australia, these companies have long been a disproportionately popular target for activist campaigns. From 2011-2015, natural resources companies accounted for nearly 60% of all activism activity, even though they currently account for only approximately 40% of all listed companies, with metals and mining companies constituting the bulk of the campaigns, along with oil and gas production-related corporates.

Facing downward pressure on commodities in the past year, activists continue to diversify, expanding their reach into sectors that have historically avoided significant activist attention in Australia. Financial companies represented 10% of all targeted stocks in 2016, while consumer services made up 7% — and natural resource companies fell under 50% — proving no industry is immune to the activists’ cause.

Activist profile

Domestic investors have historically been, and remain, the main drivers of shareholder activism in Australia, but foreign influence is expected to impact the future state of Australian activism.

Exhibit 4

Investor breakdown (2011-2016)

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>90%</td>
</tr>
<tr>
<td>Foreign</td>
<td>9%</td>
</tr>
<tr>
<td>Both</td>
<td>1%</td>
</tr>
</tbody>
</table>

Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017.

Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.
Domestic activists

While activism is in the nascent stages as an asset class, it has shown concrete signs of maturation. In recent years, and in line with a broader global trend, Australia has seen the emergence of a number of dedicated funds that pursue activist investing as one of their primary strategies. Occasional dissidents continue to drive the bulk of campaigns; however, dedicated activist funds are expected to become the key driving force behind the strategy. In 2016, 24% of campaigns by domestic activists were launched by dedicated funds, up from 12% in 2014.8

Exhibit 5

<table>
<thead>
<tr>
<th>Occasional dissidents</th>
<th>Dedicated activists</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Usually existing investors</td>
<td>• The number of funds whose primary strategy is to pursue activism is small, but growing</td>
</tr>
<tr>
<td>• Frequently individuals/concerned shareholder groups</td>
<td>• A number of funds have recently raised money solely to engage in activism</td>
</tr>
<tr>
<td>- Often one-time activists</td>
<td>• Tackle board matters, but primarily focus on value strategies</td>
</tr>
<tr>
<td>• Mostly focused on board-related activism</td>
<td>• Responsible for most large-cap activism</td>
</tr>
<tr>
<td>- Occasionally pursue value opportunities</td>
<td>• Use tactics evolving from the U.S. experience</td>
</tr>
<tr>
<td>• Primarily target small-cap companies, where the 5% shareholding requirement to call a meeting is easier to meet</td>
<td>• Public letters to the board, white papers, etc.</td>
</tr>
</tbody>
</table>

Foreign activists

Foreign activists, mainly from the U.S. but also Europe, Canada and Asia, have pushed for changes at Australian corporates in the past. However, Australia has not yet received the same influx of U.S. activist investors as other regions, primarily Europe and to some extent Asia. This is expected to change, and inbound activism to increase, as U.S. funds continue to look beyond their saturated home market for opportunities to deploy capital abroad.

Armed with a proven track record and more access to capital than local funds, experienced foreign activists are more likely to employ complex strategies and sophisticated tactics. Typically, these activists will also show less tolerance for unresponsiveness to shareholder concerns, along with a willingness to target even the largest of companies, which will continue to drive the evolution of the strategy.

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8 Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.
Institutional investors
Institutional investor support has been the driving force behind the success of global shareholder activism and it will be a crucial factor in the growth and success of the strategy in Australia as well.

As the strategy evolves, so too does the attitude of Australian long-only investors. They have historically been inclined to side with management and engage privately, but are now increasingly focused on shareholder-friendly corporate governance and share price performance. Australia’s money managers are no longer shying away from public confrontation when traditional behind-the-scenes engagement proves ineffective; they are showing an increased willingness to support a vocal dissident shareholder calling for change. In some cases, managers have gone as far as spearheading campaigns themselves. For instance, UniSuper has publicly opposed the restructuring of a portfolio company on valuation grounds, while Perpetual has been active with a number of campaigns, including attempting to break up cross-ownership schemes, and opposing changes in strategy. They also have proved successful in forcing a company to reverse an announced strategic decision.

Companies can no longer assume institutional investors are management-friendly, or presume their votes will favor incumbents. Instead, companies must adapt their activism preparation and response tactics to a new reality where every substantial holder in a company’s register is a potential activist or activist supporter.
Campaign themes

Most activist campaigns since 2011 have revolved around implementing changes to companies’ boards. Activists have historically sought to remove and replace directors to drive shareholder value, based on their premise that entrenched boards and complacent management teams are the root cause of share price underperformance. In recent years, activists have tallied increasing success rates with such campaigns, coupled with solid volume. Since 2011, over 300 campaigns have focused primarily on altering the makeup of corporate boards.9

Exhibit 7

<table>
<thead>
<tr>
<th>Primary campaign type breakdown (2011-2016)9</th>
<th>Campaigns resulting in activist board representation2,6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board related</strong></td>
<td><strong>At least one board seat for the activist</strong></td>
</tr>
<tr>
<td>82%</td>
<td>79%</td>
</tr>
<tr>
<td><strong>Board seats</strong></td>
<td><strong>No seats for the activist</strong></td>
</tr>
<tr>
<td>67%</td>
<td>76%</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td><strong># of campaigns</strong></td>
</tr>
<tr>
<td>18%</td>
<td>2014: 73, 2015: 71, 2016: 54</td>
</tr>
<tr>
<td><strong>Remove director; no dissident nominee to fill vacancy</strong></td>
<td>2014: 21%, 2015: 24%, 2016: 31%</td>
</tr>
<tr>
<td>15%</td>
<td></td>
</tr>
</tbody>
</table>

Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017.

9 Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

b Completed campaigns: Completed means a proxy fight was withdrawn, settled or a winner has been announced or for a non-proxy fight activist campaign there has been a logical conclusion (e.g., value demand was granted, activist withdrew demands/sold stake etc.); 1%, 11% and 27% of campaigns announced in 2014, 2015 and 2016, respectively, are still pending.
While corporate governance and board composition remain the main catalysts for activism in Australia, value demands are becoming increasingly common. Activists are beginning to ground their campaigns on value maximization themes and are putting forward specific value propositions rather than solely calling for board spills. In recent years, popular campaign themes have included opposition to announced deals and the return of capital to shareholders, representing 31% and 24% of all value demands, respectively.10

Campaign themes and demands become progressively sophisticated as targets get larger. Whereas activism at small-cap companies is mostly focused on governance concerns, activists targeting larger stocks have proved willing to favor and pursue value strategies.

Exhibit 8

<table>
<thead>
<tr>
<th>Activist campaigns with at least one value demand$^{a,b}$</th>
<th>Activist campaigns with at least one value demand by market cap (2011-2016)$^{a,b,c}$</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 6 3 17 23 21</td>
<td>264 52 33</td>
</tr>
<tr>
<td># of campaigns</td>
<td># of campaigns</td>
</tr>
<tr>
<td>At least one value demand</td>
<td>No value demands</td>
</tr>
<tr>
<td>87% 65% 55%</td>
<td>13% 35% 59%</td>
</tr>
</tbody>
</table>

Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017.

$^a$ Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.

$^b$ Individual campaigns may be classified under various value demand categories.

$^c$ Market cap in USD, as of announcement date; campaigns removed when market cap data is unavailable.

10 Sources: FactSet, SharkRepellent, Activist Insight, Mergermarket, company filings, press articles as of Apr. 17, 2017. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger.
3. Implications for Australian companies

In the past, companies have prepared for activists by hiring advisors to identify potential vulnerabilities, by briefing the board, and by developing a “break glass” plan to be implemented in the event an activist launches a campaign against the company. With the evolution of the strategy, these reactive measures are no longer enough. As part of their business plans, Australian companies should look to employ proactive measures, based on global best practices, aimed at eliminating the activist threat before it ever materializes.

Communicate proactively and clearly with shareholders

Good communication with shareholders has been an essential part of the shareholder activism preparation process for years. As the strategy and landscape evolve, companies also need to consider other stakeholders in the course of their regular external outreach. A robust communications plan should address multiple potential constituencies:

Exhibit 9

<table>
<thead>
<tr>
<th>Stakeholder constituencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional investor governance teams</td>
</tr>
<tr>
<td>Portfolio managers</td>
</tr>
<tr>
<td>Key non-shareholder influencers</td>
</tr>
</tbody>
</table>

Institutional investor governance teams

In contrast to just a few years ago, when many large institutional investors outsourced voting decisions to proxy advisors such as ISS and Glass-Lewis, the largest institutional investors — and a growing number of smaller institutional investors — have built out internal corporate governance teams tasked with making voting decisions and ensuring consistent voting across investment vehicles. The team may operate independently from fund investment professionals or, alternatively, may work in concert with them to make voting decisions. Regardless, it is critical for companies to understand how each team thinks about corporate governance issues as well as their vote decision-making process, and to engage with them as part of the company’s regular outreach efforts.

Portfolio managers

While large institutional investors have built in-house teams, many long-only fund managers still retain some input over voting decisions. As activism has proliferated, portfolio managers have become increasingly comfortable supporting activists and their campaigns.
A number of fund managers have developed relationships with established activists and are increasingly expressing concerns about portfolio companies directly to activists (in addition to, or instead of, to the company), and many times encouraging the activist to get involved. Ultimately, actively managed fund managers can and do vote with their feet regardless of their fund’s proxy voting decision process. As such, companies need to ensure that this group understands their overall strategy, is supportive and feels that its voice is being heard.

Key non-shareholder influencers

Key non-shareholder influencers include proxy advisors, corporate governance experts, influential reporters and academic subject matter specialists. Because so much activism occurs in the public spotlight, companies need to determine who these thought leaders are and, to the extent it makes sense, keep them continually engaged. In the event of an activist campaign, having these relationships also helps the company ensure that its side of the story is fairly portrayed.

Think strategically about all external communications

While it is still critical to understand how an activist might attack the company and to prepare a plan for responding to an activist campaign, management and boards should also strive to view the company’s long-term communications plan through the lens of activism. The advent of activism among nontraditional constituencies, including non-shareholder influencers, requires that the company not only prepare for the traditional activist but also take a strategic approach to normal course shareholder communications and ongoing media engagement. To that end, companies should seek to consistently convey the following key points across all of their external communications platforms:

1. Well-developed corporate strategy
   - Communicate financial and strategic priorities to investors effectively and consistently.
   - Tell the company’s story, beyond reporting results, by highlighting its strong trajectory and any company “wins,” with a focus on being a responsible steward of shareholder capital and proactively addressing inefficiencies.
   - Address any “losses” head-on, before an activist has the opportunity to capitalize on them.

2. Board and senior management engagement
   - Demonstrate senior management and director commitment to maximizing long-term shareholder value.
   - Engage regularly with shareholders and key influential third parties (media, academics, industry icons, etc.).
   - Ensure that top investors feel their concerns are being heard.

3. Appropriate corporate governance structure
   - Demonstrate a record of self-assessment and proactive change.
   - Recognize corporate governance trends and avoid becoming a governance laggard.
Proactively address corporate governance lightning rods

Virtually all activist campaigns involve criticism of a company’s corporate governance. No matter what the specific campaign demands are, the activist’s starting premise is likely to be that the management team and board have not acted to fully maximize shareholder value during their tenure. Heightened board scrutiny can make directors particularly vulnerable during activist campaigns, especially if the activist is trying to gain board seats. Directors should be prepared to have their collective competence and credibility challenged. Individual directors may also be singled out and targeted by attacks that can quickly turn personal and impugn reputations.

To demonstrate their commitment to corporate governance excellence, companies should undertake periodic self-assessments to evaluate board composition and various hot-button corporate governance issues. Doing this proactively mitigates potential toeholds for activists who might otherwise include corporate governance changes as a valid campaign objective. It has become even more important today, as the top activists have access to a stable of well-qualified board candidates with expertise across industries, which comforts shareholders in ousting directors from boards with governance issues.

Finally, companies should communicate to the broader shareholder base that they are regularly performing this type of self-evaluation, and that management and the board are focused on good corporate governance.

Be ready to engage if and when activists show up

Companies must be willing to engage in dialogue with all shareholders, including activists. However, it is important to prepare in advance for any prospective interaction with an activist because these discussions can rapidly transform into hostile situations. This shift can happen quickly and companies may not have the time to build an internal framework for responding to every stage of the campaign, thus opening the door to confusion among management and the board and potentially giving the public perception of a disorganized response.
In planning for a potential activist campaign, companies should consider the following best practices:

**Exhibit 10**

<table>
<thead>
<tr>
<th>Best practices for preparing for activists</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1 Establish external and internal working teams</strong></td>
</tr>
<tr>
<td>• Establish internal activism team including key members across corporate functions and operating segments</td>
</tr>
<tr>
<td>• Engage roster of best-in-class activism advisors</td>
</tr>
<tr>
<td>- Investment bank</td>
</tr>
<tr>
<td>- Public relations firm</td>
</tr>
<tr>
<td>- Attorneys</td>
</tr>
<tr>
<td>- Proxy solicitor</td>
</tr>
<tr>
<td><strong>2 Evaluate strategic planning through the lens of an activist</strong></td>
</tr>
<tr>
<td>• Update financial projections by segment, with reflection on peer benchmarking</td>
</tr>
<tr>
<td>• Consider the strategic importance of each segment and whether the market gives the company “full credit” for the value of the current corporate structure</td>
</tr>
<tr>
<td>• Determine optimal capital structure</td>
</tr>
<tr>
<td><strong>3 Complete scenario planning/fire drills</strong></td>
</tr>
<tr>
<td>• Analyze vulnerabilities and produce a mock activist attack deck</td>
</tr>
<tr>
<td>• Prepare standard responses to anticipated campaign attacks</td>
</tr>
<tr>
<td>• Prepare internal and external communication materials</td>
</tr>
<tr>
<td><strong>4 Monitor shareholder base</strong></td>
</tr>
<tr>
<td>• Closely monitor shareholder base on an ongoing basis</td>
</tr>
<tr>
<td>• Understand shareholder motivations</td>
</tr>
<tr>
<td><strong>5 Board should receive updates at least annually</strong></td>
</tr>
<tr>
<td>• Directors should be prepared for spotlight by activist</td>
</tr>
<tr>
<td>• Banker and lawyer updates with directors</td>
</tr>
<tr>
<td>- Current environment</td>
</tr>
<tr>
<td>- Fiduciary duty</td>
</tr>
<tr>
<td>- Legal considerations</td>
</tr>
<tr>
<td>• Proactively determine governance deficiencies and adopt required policies</td>
</tr>
</tbody>
</table>
4. J.P. Morgan M&A advisory solutions and shareholder activism expertise

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

Clients benefit from customized solutions combining:

- In-depth knowledge of sector and market dynamics with M&A bankers based locally in most major markets globally.
- Innovative advice on valuation, transaction structures, and deal tactics and negotiations.
- Rigorous execution delivered with responsive and agile service.
- Ability to partner with product experts across our full range of competencies, including comprehensive financing through our debt and equity issuance platforms, as well as derivatives and treasury services, including escrow services.

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

Shareholder strategy

J.P. Morgan has an extensive record of helping clients prepare for and respond to shareholder activism. Our size and scale, wide array of product offerings and experience enable us to provide a differentiated approach to shareholder activism defense for clients, including:

- Defense preparations for publicly announced and non-public approaches.
- Dedicated shareholder activism advice.
- Advising corporate clients only.
  - J.P. Morgan does not advise shareholder activists on activist campaigns.
  - Interests are fully aligned with company interests and enhancing long-term shareholder value.
- Experience with all major activists in some of the most sophisticated campaigns around the world.
  - Deep understanding of potential activist tactics.
  - Firsthand experience of what works when defending against an activist.

Strategic expansion

- Acquisitions, including cross-border opportunities.
- Mergers and joint ventures.

Enhancing business value

- Corporate combinations.
- Divestitures.
- Capital restructuring projects.
- Spinoffs and other repositionings.
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