June 2015

# VALUING THE VOTE

## The Impact of Proxy Voting **on SBA Portfolio Holdings**

Empirical **ANALYSIS** of Proxy Contests

SBA FLORIDA
STATE BOARD OF ADMINISTRATION

# Executive Summary

**First of its kind empirical analysis of institutional investor's proxy voting decisions involving dual board nominees and impact on portfolio value.**

**Study examines all proxy contests occurring between January 1, 2006 and December 31, 2014 at U.S.-domiciled companies with market capitalizations exceeding $100 million. SBA total investment across all examined companies, at time of contest announcement, equal to $1.9 billion.**

**Study evaluates SBA proxy voting decisions related to 107 distinct proxy contests, in which the SBA supported one or more dissident board candidates 65% of the time during the study's time frame.**

**Among SBA votes to support one or more dissident nominees where the dissident won seats, the company's subsequent 1, 3, and 5-year relative cumulative stock performance was positive, at levels of 12%, 21%, and 26%, respectively. The same returns for cases where SBA supported the dissident but management won all seats were negative, at -14%, -16%, and -15%.**

**SBA votes supporting management in initial contests when management subsequently won all seats were associated with a positive economic portfolio gain equal to $137 million over the study's time frame. When SBA supported the dissidents but management won all seats, SBA experienced an aggregate loss of $259 million over the study's time frame.**

**SBA votes supporting dissident nominees where the dissident won in initial contests were associated with a positive economic portfolio gain equal to $51 million in the five years after a contest is announced, over the study's time frame from 2006 to 2014.**

**Study demonstrates SBA equity value linked to proxy contest holdings increased by $572 million (or $5.3 million per vote) in the five years after a contest is announced, during the study's time frame from 2006 through 2014.**

*ACKNOWLEDGEMENTS:*

*SBA staff would like to acknowledge and thank the following individuals for their advice and assistance in developing this study: Michael Levin, The Activist Investor (TAI); Corina Florea and Meghan Orifici, Institutional Shareholder Services (ISS); Tony Modica and Shawn Dupont, FactSet Research Systems/SharkRepellent; Lydia Mulyk, Okapi Partners; Husein Bektic and James Martin, Activist Insight; and Brian Scott, Tableau Consultant.*

# Data Sources and External Research Information

**SBA staff were assisted by several outside parties, including FactSet Research Systems, Institutional Shareholder Services (ISS), and The Activist Investor (TAI).**

## FactSet Research Systems - SharkRepellent Database

FactSet provided company, industry, and stock performance data for this study. The FactSet SharkRepellent database includes over 1,000 relevant activist situations logged since January 1, 2006. SharkRepellent establishes a start date for each situation based on their review of the facts, including the filing of a Form 13D, a news release, or other information. SharkRepellent also identifies the kind of activism each situation involves, including proxy fights, shareowner proposals, and say-on-pay votes. FactSet Research Systems Inc. provides integrated financial information and analytical applications to the global investment community. It combines content regarding companies and securities from major markets all over the globe, consolidating content from hundreds of databases.  Its applications provide users access to company analysis, multicompany comparisons, industry analysis, company screening, portfolio analysis, predictive risk measurements, alphatesting, portfolio optimization and simulation, real-time news and quotes and tools to value and analyze fixed income securities and portfolios.

## Institutional Shareholder Services (ISS)

ISS provided historical data on SBA proxy votes and related information for this study. ISS is a provider of governance research, voting recommendations and voting services to over 1,600 institutional investor clients. ISS governance services cover over 30,000 shareowner meetings each year in 115 developed and ermerging markets worldwide.  ISS has the largest integrated global research team of any proxy advisor, with more than 250 research and data professionals located in Europe, North America, Asia, and Australia.

## Michael Levin - The Activist Investor (TAI)

Michael Levin assisted SBA staff in its analysis of the performance impact of SBA proxy voting. TAI was developed by Michael Levin, an investor, corporate executive, and management consultant, with almost thirty years' experience in investing, corporate finance, strategy, and risk management.

He currently serves on the Board of Directors of Comarco, Inc. and AG&E Holdings, Inc. Mr. Levin is experienced in all aspects of equity turnaround, and as an activist investor. As a management consultant and finance executive he has worked on numerous turnaround cases in a range of industries. Throughout his business career his efforts increased the value of equity investments many times.

Mr. Levin holds both bachelor's and master's degrees in economics from the University of Chicago. His consulting career includes leadership positions at Towers Perrin and Deloitte and he has also held executive positions in finance at CNH and Nicor.

## About the SBA

The State Board of Administration (SBA) is a body of Florida state government that provides a variety of investment services to clients and governmental entities. These include managing the assets of the Florida Retirement System, the Local Government Surplus Funds Trust Fund (Florida PRIME™), the Florida Hurricane Catastrophe Fund, and over 30 other fund mandates.

As of March 31, 2015, the SBA managed approximately $185 billion in total assets.

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## Environmental

# SBA Approach To Voting on Proxy Contests

**As an institutional shareowner that invests funds on behalf of many of Florida's citizens, the SBA fulfills its fiduciary duties by carefully monitoring proxy contests and by participating in them in a way that will maximize the return to its constituents: fund participants and beneficiaries.**

Proxy voting is a legal term for how a shareowner submits votes on corporate matters in lieu of physically attending a company's annual meeting. It occurs when a company's shareowner authorizes the exercise of their voting rights. Typically, there is but one "proxy" on which to cast votes: the proxy submitted by the company's board at an annual or special meeting. Occasionally, however, an individual shareowner will issue a competing proxy statement, with an aim to make some additional change at the company. The most aggressive campaign would be to run an alternative slate of directors for election to the company's board, but some matters covered by shareowner-sponsored proxy statements are mundane matters such as opposing compensation plans or presenting shareowner proposals for procedural matters at the company, often concerning voting rights of shareowners. Regardless of the content of the shareowner-sponsored proxy's content, this is called a proxy contest or a proxy fight.

Individual and institutional shareowners may use a proxy contest as a solicitation for other owners' support in order to challenge the composition of a company's board of directors. When shareowners do not believe that the company's board of directors has taken the necessary steps to maximize shareowner value, these shareowners may initiate a campaign to remove members of a company's board of directors and try to replace these directors with their own candidates. The increase in large institutional investors as active shareowners in public corporations has brought with it a rise in the number of such proxy solicitations.

**When voting on proxy contests, the SBA makes case-by-case decisions, examining company specific factors and historical financial performance. As part of its voting analysis, the SBA evaluates the following criteria:**

1. Past performance relative to its peers
2. Market in which the fund invests
3. Measures taken by the board to address the issues
4. Past shareowner activism, board activity, and votes on related proposals
5. Strategy of the incumbents versus the dissidents
6. Independence of directors
7. Experience and skills of director candidates
8. Governance profile of the company
9. Evidence of management entrenchment

When analyzing proxy contests, the policy focuses on two central questions: (1) Have the dissidents demonstrated that change is warranted at the company, and if so, (2) will the dissidents be better able to affect such change versus the incumbent board? When dissidents seek board control, the dissidents must provide a well-reasoned and detailed business plan, including the dissident's strategic initiatives, a transition plan that describes how the dissidents will affect change in control, and the identification of a qualified and credible new management team. The SBA compares the detailed dissident plan against the incumbents' plan, and the SBA compares the dissident's proposed board and management team against the incumbent team.

When dissidents seek minority board representation, the SBA places a lower burden of proof on the dissidents. In such cases, the SBA's policy does not require the dissidents to provide a detailed plan of action or proof that its plan is preferable to the incumbent plan. Instead, the dissidents must prove that change is preferable to the status quo and that the dissident slate will add value to board deliberations, including by considering the issues from a viewpoint different than current management, among other factors.

**To exercise its fiduciary duties under Florida statutes, the SBA will only consider factors that affect the SBA's investments, and it will not subordinate the interests of SBA account participants or beneficiaries to its own or other interests when voting its shares.**

Of course, this is called a proxy fight for a reason; some companies, via their challenged board of directors, may vehemently resist such platforms by engaging in a costly proxy battle, and even possibly by pursuing litigation if they feel that the challenging shareowners have violated federal securities laws in their pursuit of the proxy contest. Companies may also use courts to hedge against the possibility that shareowners may agree with the dissidents since courts can enjoin dissidents from voting their shares and their proxies. Generally, corporations are free to use corporate resources to defend members of their board of directors, the corporate bylaws, and any other challenged business practice during proxy contests. Recent disclosures show that for a large market-cap company, each side can easily spend in excess of $10 million defending and marketing their proxy.

More than 99.5 percent of annual company meetings do not involve proxy contests. They instead simply feature the company's board nominees and provide investors with the choice of supporting the elections or casting "against" or "withhold" votes (a legal distinction depending on the company's election standards and protocol). In these cases, which are the overwhelming majority of corporate elections, the nominees are not challenged and will be elected to the board. Even directors who do not acheive support from a majority of the voting shares typically remain on the board. Proxy contests are, therefore, a unique and unusual opportunity to replace company directors.

In the absence of a proxy contest for board elections, the SBA generally votes 'For' directors up for election, typically supporting over 80 percent of all director candidates. However, after taking into consideration unique country-specific practices and disclosure standards, the SBA may vote against (i.e., "withhold" support for) director nominees for a variety of reasons. Primary factors that lead SBA staff to vote against (or withhold) for an individual director include: 1) lack of stock ownership; 2) poor attendance at meetings (e.g., if less than 75 percent attendance rate); 3) whether they are inside or outside of the company in those circumstances where the full board comprises less than 50 percent independence levels; 4) negligence in board committee performance; 5) inaction in response to a material shareowner proposal that was either approved by a majority of votes cast or approved by a majority of the shares outstanding; 6) "over-boarded" directors (SBA staff are likely to withhold support from a director who simultaneously serves on more than 3 outside boards); and 7) a poor performance track record across all the company boards upon which the individual serves as a director.

## What is a Proxy Fight?

A proxy fight is a campaign under which a shareowner or group of shareowners (the "dissident") solicits the proxy or written consent of other investors in support of a resolution it is advancing. This usually involves the election of dissident nominees to the company's Board of Directors in opposition to the company's director nominees but may also involve campaigns to approve a shareowner proposal or to vote against a management proposal (including approving a merger). In a proxy fight, the dissident files a separate proxy statement and card, apart from the company's proxy materials. The SEC requires the dissident to follow prescribed procedural and disclosure requirements to conduct a proxy fight (Rules 14a-1 to 14a-13 of the Securities Exchange Act of 1934). As soon as a dissident publicly discloses that it has delivered formal notice to the company that it intends to solicit proxies from shareowners (for example, for the election of its own slate of director nominees), it is considered a proxy fight.

# Study's Objective: Assess Efficacy & Quantitative Value of SBA Proxy Voting

**This study is intended to provide insight for the SBA's constituents and the institutional investment community regarding the SBA's voting procedures and portfolio returns, specifically in the context of a proxy contest.**

The SBA, which manages over $185 billion in assets, owns shares in thousands of publicly-traded US corporations. As a shareowner, the SBA has a fiduciary duty to cast votes on various matters at each of these corporations.

The SBA maintains an active department, Investment Programs and Governance (IPG), that researches how to vote on these matters each year. As 2014 came to an end, the SBA set out to analyze the impact on portfolio returns of this department and its related research and voting activities.

While proxy contests are costly and may deplete shareowner value through the consumption of the company's resources in fighting the proxy contest, the challenging shareowners typically agree that the benefits resulting from a proxy contest surpass the costs involved to conduct them.

To accentuate shareowner value further, some members of the investment community have propositioned companies to adopt bylaw amendments that will provide for shareowner reimbursement for the expense of waging a proxy contest if a shareowner realizes an increment of success in the proxy contest, such as winning seats on the board of directors.

**In 2014, the SBA was ranked as the top institutional investor by Activist Insight in voting support for dissident slates of directors in proxy contests.**

**As shown by the results of this study, the SBA's investment staff has demonstrated a positive influence on portfolio returns due to its voting decisions.**

**To analyze this effect, SBA staff reviewed the returns for a targeted sample of the companies in the SBA portfolio. Based on this analysis, proxy voting decisions were linked with increased returns of 30 percent on the original invested value, worth $572 million in additional asset appreciation.**

**The results of this study do not necessarily show causation, merely correlation among the SBA's voting decision and subsequent positive stock performance.**

## VOTING IMPACT

### STOCKS INCREASE IN VALUE

For the two years before the proxy contest, average stock performance was -1%. In the year following the proxy contest, average stock performance equaled 9%.

9%▲

### MULTI-YEAR EFFECT

In the two years following the proxy contest, average stock performance equaled 25%. During the full 5 years after activist initiatives, average stock performance was 67%.

67%▲

### VALUE BEYOND MARKET

In all time periods (1,3, and 5 year) and for both relative and absolute measures, the average performance of the firms was better when the market vote (i.e., contest victor) agreed with the SBA vote.

When the market voted differently than the SBA, stock performance lagged.

# Research on the Effects of Hedge Fund Activism

**Over the last several years, the rise in hedge-fund activism at large companies including Darden Restaurants, Apple, Hess, Timken, Microsoft, CommonWealth and others has raised the stakes in corporate governance, investor engagement and related investor voting on proxy contests.**

Opponents of activist investors' efforts view such activism as a threat to the corporate business model and the long-term performance of targeted firms, imposing an overly short-term orientation and lowering future performance.

In contrast to such negative views of investor activism, there is a growing body of empirical research that indicates a positive effect on earnings per share and share price appreciation. One study on the incumbent directors in contest, "Shareowner Democracy in Play: Career Consequences of Proxy Contests," found that following a proxy contest, incumbent directors experienced a decline in the number of directorships in the future, not only at the company involved in the proxy contest but also at other companies on which the same directors served. Other studies have surfaced over the last few years clearly demonstrating the short and long-term effects of investor activism, describing their influence and changes to market structure that result from their actions. A study from 2013 titled "Myths and Realities of Hedge Fund Activism: Some Empirical Evidence," finds that the vast majority of actions by activist hedge funds were not hostile to incumbent management and board members, underscoring a friendly bias in fund tactics and strategies. The study examined 432 activist campaigns launched by 129 unique activist hedge funds across 17 countries between January 1, 2000 and December 31, 2010. This study presents empirical data in non-U.S. equity markets on the nature of activist hedge funds, offering policymakers further evidence of the positive impact of hedge fund activism. The study's author concludes that activist hedge funds do not undermine the role of the board of directors as the central decision-making body.

Other studies show several notable financial impacts of investor activism. In "The Disciplinary Effects of Proxy Contests," researchers examined the direct and indirect effects of proxy contest actions, finding evidence to suggest that targets of proxy contests increased leverage, reduced spending on research & development, reduced capital expenditures, increased dividend payouts, and decreased CEO compensation in the period before the

**In one of the most recent studies published on the topic of activist investors, a large dataset of hedge fund interventions from 2008 through the first half of 2014 was examined.**

**Researchers found that both the number of hedge fund activists and their interventions have increased and the post-announcement, abnormal stock returns continue to be positive.**

**The study's authors also found that returns are significantly higher for "top" hedge fund activists that make larger investments, with the researchers concluding that the most successful activists have been those with the highest assets under management, invest in fewer (but concentrated) portfolio companies, are more experienced with similar investment strategies, and have had a history of holding board seats at target firms.**

**The study concludes that, "post-intervention, target-firm operating performance associated with these top hedge funds is significantly superior to that of other hedge fund activists."**

**Research has found that activist interventions were much more likely to identify and pursue target firms where there was a clear pattern of financial and stock price under-performance.**

proxy contest took place. The study's author states, "companies experience positive and significant stock returns when a proxy contest materializes, without reversals in the long run." Researchers concluded that the proxy contest does indeed play a strong, positive disciplinary role. They also find that proxy contest mechanisms provide companies with "monitoring pressure" thereby positively impacting their policies and corporate conduct.

Perhaps the most comprehensive study on the effects of proxy contests and activist investors was published in 2013, titled "The Long-Term Effects of Hedge Fund Activism." In this study by Harvard Law School professor Lucian Bebchuk, Duke University's Alon Brav, and Columbia University's Wei Jiang, empirical evidence is presented more likely to identify and pursue target firms where there was a clear pattern of financial and stock price under performance. Target firm operating performance was found to significantly lag their corporate peers during the preceding three years leading up to the intervention. Furthermore, the companies' stock price returns were abnormally negative. The authors of the study observed that target firms' post-intervention operating performance and valuation measures over the subsequent five-year period improved significantly.

An early 2015 study, "Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value?," shows that activist hedge funds create long-

> *"Activists are owners whose focus on value protects investors from managers who can become too self-interested. Activists also press for companies to use their cash or return it to shareholders, who can then invest it in some other useful purpose."*
>
> **- Wall Street Journal, Review & Outlook, May 14, 2015**

showing the long-term impact of hedge fund activism. The researchers find that such activity contributed positively to both the short and long-term performance of targeted companies. The study analyzes the effectiveness of the proxy contest mechanism leading up to the financial crisis in late 2008, examining all U.S. proxy contests taking place from 1994 to 2008.

Several studies attempt to examine the effects on companies that have experienced a proxy contest (normally referred to as "ex post" effects). Researchers found that activist interventions were much

term value by, "sending affirming signals to the board of directors that its executive management team may be making inefficient decisions and providing recommendations on how the company should proceed in light of these inefficiencies." As a result, study authors conclude these signals push boards to critically review and question the direction executive management is taking.

Notably, this study attempts to explain why activist funds have historically avoided long-term investment proposals—"the stock market signals provided by value investors voting with their feet are telling the rest of the stock market that a particular public company is poorly managed and that it either needs to be replaced or given less assets to manage." Therefore, the researchers conclude that activist hedge funds will primarily focus on a reduction in the amount of assets under the control of incumbent managers.

# SBA Corporate Governance & Proxy Voting

## Proxy voting decisions are made independently, based on written corporate governance principles and proxy voting guidelines developed internally.

To exercise its fiduciary duties under Florida Statutes, the SBA will only consider factors that affect the SBA's investments, and it will not subordinate the interests of the SBA plan's participants or beneficiaries to its own or other interests when voting its shares. Accordingly, the SBA relies on a number of quantitative and qualitative resources in fulfilling its fiduciary duties while voting proxies.

First, the SBA has developed a number of internal policies that it employs when making any voting decision, whether the vote regards routine matters or the vote regards substantive issues challenged in a proxy contest. The SBA's internal policies focus on the corporate governance practices of the companies that it owns because a particular company's corporate governance practices affect the rights of, and returns to, its shareowners. In general, the SBA's policies promote measures that expand shareowner rights and maximize shareowner returns, and its policies shun measures that act contrary to these goals.

The SBA sometimes discusses matters with other significant investors and subscribes to specialized research on matters of proxy voting. In addition to the advice of investors and advisors, the SBA conducts its own review of the corporation when deciding on how to vote its shares. The SBA considers the company's financial performance over the short-term and long-term, and according to the internal policies discussed above, the SBA assesses the company's corporate governance practices. In regard to a proxy contest, the SBA will review the proxy statements from the competing sides and weigh the positives and negatives of each argument.

The SBA makes all proxy voting decisions independently, casting proxy votes based on written corporate governance principles and proxy voting guidelines it develops internally for common issues expected to be presented for shareowner ratification. The SBA's proxy voting guidelines reflect its belief that good corporate governance practices will best serve and protect the funds' long-term investments and are reviewed and approved by the SBA's Investment Advisory Council and Board of Trustees on an annual basis. The SBA's voting policies are developed using empirical research, industry studies, investment surveys, and other general corporate finance literature. SBA voting policies are based both on market experience and balanced academic and industry studies, which aid in the application of specific policy criteria, quantitative thresholds, and other qualitative metrics.

**$3 billion**

**Average market capitalization of all examined companies in the study.**

**$1.9 billion**

**Total SBA investment across all examined companies, at time of contest announcement.**

**$18 million**

**Average SBA investment in each company examined in the study.**

# Study's Methodology: Analyze Long-term Sample of SBA Portfolio Companies

**64%**

69 of the 107 studied activist campaigns involved a 13D filing with the Securities & Exchange Commission (SEC). A 13D filing is required whenever an investor breeches the 5 percent ownership threshold and is considered an "active" shareowner seeking to influence the business practices of a company.

**64%**

68 of the 107 studied activist campaigns had outcomes matching SBA staff voting decisions. When examining the recommendations of one proxy advisor used by the SBA, Institutional Shareholder Services (ISS), a win rate of 64 percent was exhibited among all studied activist campaigns. SBA proxy voting decisions matched the ISS client recommendations 89 percent of the time.

## Criteria and Sample:

SBA analyzed a subset of the thousands of companies in the SBA portfolio. SBA selected the sample based on these criteria:

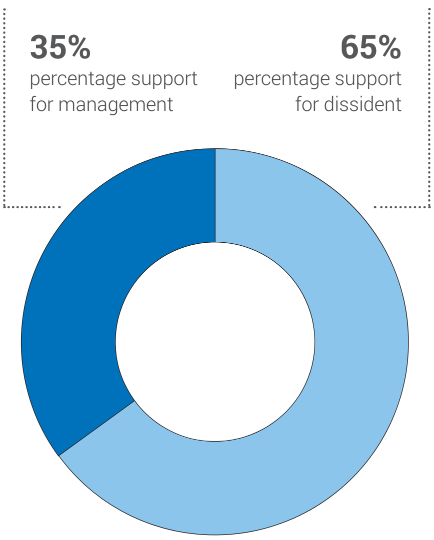
1. Companies with a contested election for one or more board of directors positions or with a contested vote on a significant transaction, such as a divestiture ("proxy contest"). We excluded votes on shareowner proposals, say-on-pay matters, and other types of contested matters.
2. Proxy contests occurring in the nine years from January 1, 2006 through December 31, 2014.
3. Market capitalization at the beginning of the announced proxy contest of at least $100 million.

In these situations, a proxy contest arises because one shareowner, or sometimes a group of shareowners, nominates directors to compete for board positions held by incumbent directors. In just 4 instances in the sample, that shareowner or group opposes a transaction or other action that the company proposes, without submitting a competing slate of director candidates.

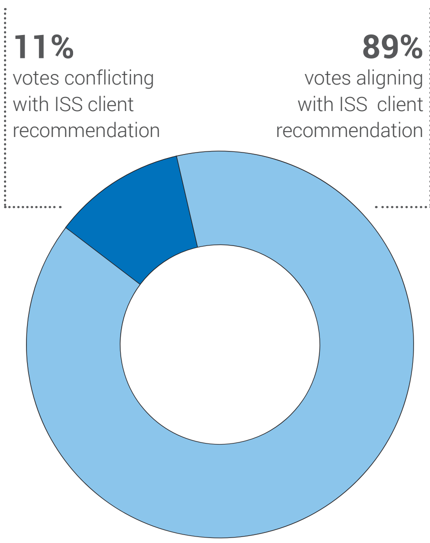
These particular situations require SBA staff to research the proxy vote and determine whether support for the shareowner or management is warranted. They thus provide a reasonable setting for determining the financial impact of that research and decisions.

Based on these criteria, SBA identified a sample of 107 proxy contests over the nine year period.

### SBA Management Support




### SBA-ISS Vote Correlation



**SBA defines a vote to support a dissident if SBA votes in favor of at least one dissident nominee for the board of directors.**

## Sample Attributes

For the sample of companies, several attributes of each proxy contest were identified and analyzed:

1. Whether SBA supported the dissident or management
2. Whether the dissident or management prevailed in the vote.

For a given company, SBA defines a vote to support a dissident if SBA votes in favor of at least one dissident nominee for the board of directors. SBA defines a vote to support management if SBA votes in favor of all management nominees for the board of directors.

For a given company, SBA defines a dissident as prevailing if one or more of a dissident nominee gains a seat on the board of directors. This can occur if a nominee wins the board of directors election. It can also occur, and frequently does occur, if the dissident and the company agree to add one or more dissident candidates to the board of directors, before the board of directors election.

Based on these definitions, for the 107 proxy contests in the sample, SBA supported the dissident and opposed management in 70 instances. SBA opposed the dissident and supported management in 37 instances. Further, for the 107 proxy contests, the dissident prevailed in 64 instances, while management prevailed in 43 instances.

**60%**

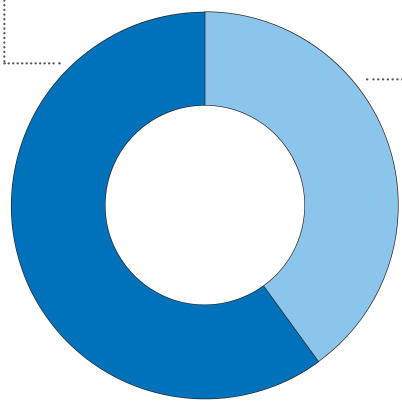
64 of the 107 studied activist campaigns were "won" by dissident shareowners, typically an activist hedge fund.

Dollar value changes in equity for each company in the sample are calculated for the longest available period (1, 3, or 5 years); if the company was acquired or taken private during the subsequent 5-year period after the contest announcement date, the terminal stock value is used to calculate returns.

### Dissident Win Rate

**60%** percentage of contests won by dissident

**40%** percentage of contests lost by dissident.



# Analysis: Portfolio Returns Improve Due to Activist Investors' Actions

## Dollar Value Increase Correlates with SBA Voting

Using SBA's equity holdings at the start of the initial proxy contest for each company in the sample, we determined the actual dollar value contribution to the portfolio over the five year period after the contest or through year-end 2014, whichever was longer.

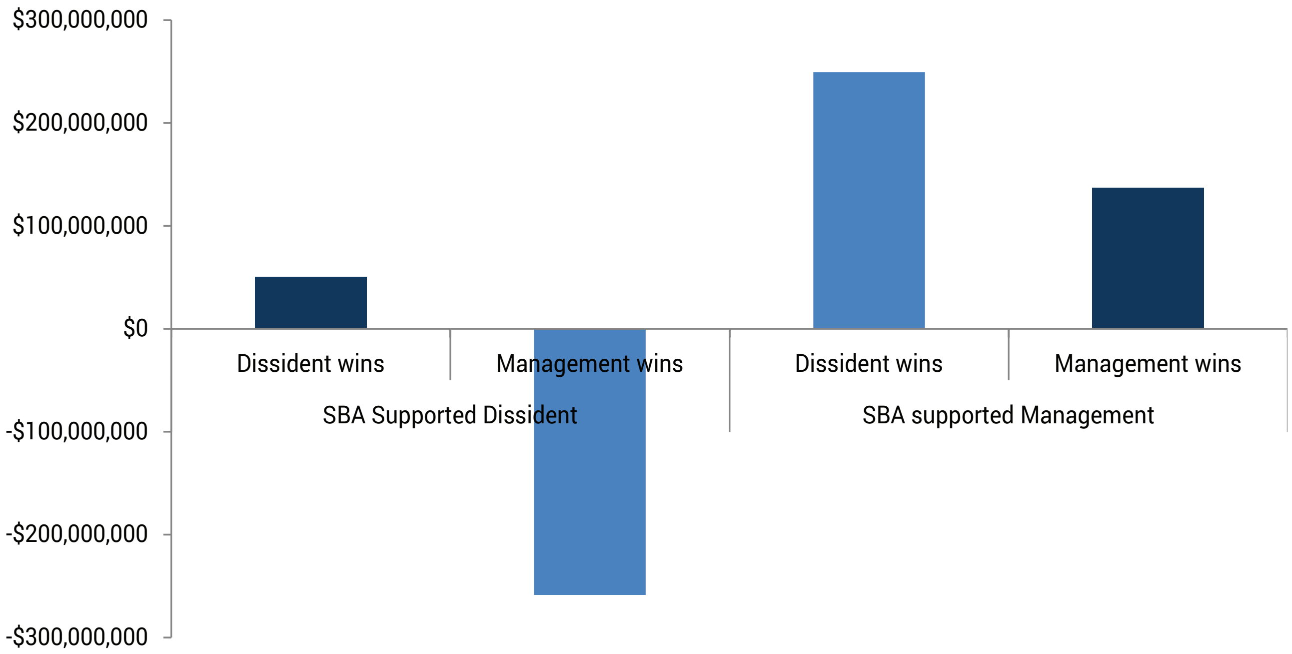
When segregated by which party SBA supported in the proxy contest, the data shows that the dollar returns to SBA are much larger when SBA supports the dissidents and the dissidents win. When SBA supported the dissidents but the net shareowner vote supported management, we observed large losses, heavily driven by one firm in the sample.

When SBA supported management and management won the contest, we observed large positive returns. When the dissidents won, the broad impact was lower returns, but a high aggregated dollar value was driven by a single outlier in the data.

**67%**

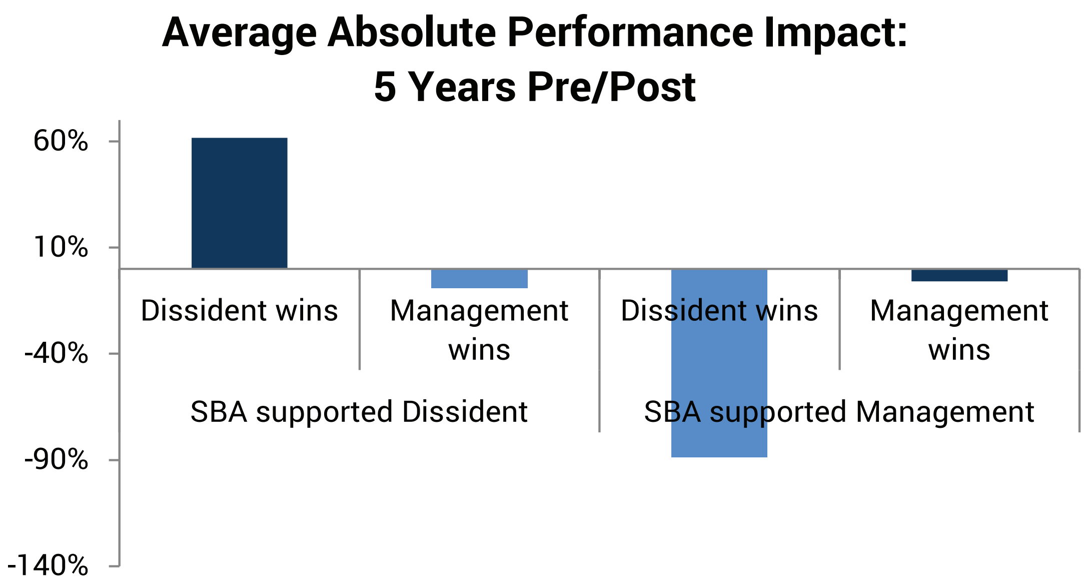
Stock performance rose in the five year period following the start of the activist campaign, when compared to the same earlier periods. On average, companies experienced a 67 percent increase in stock price over the 5 years after the activist campaign.

### SBA Dollar Value Impact After Proxy Contest (through 2014)

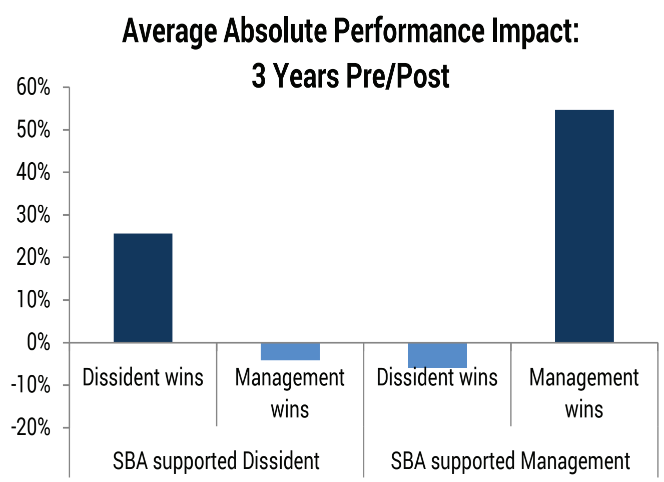


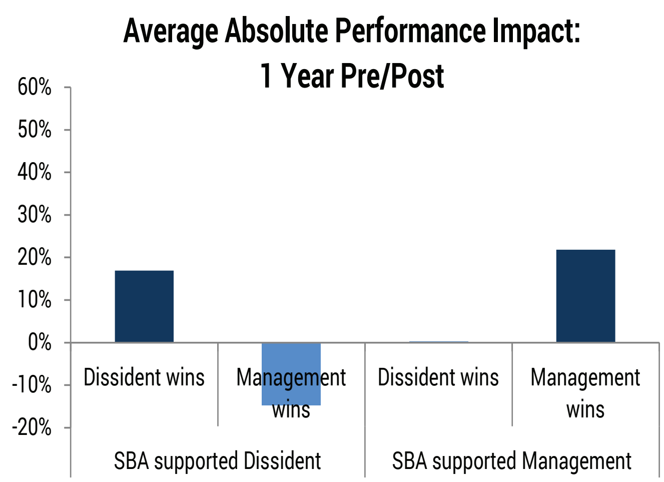

**Several companies within the dataset had multiple proxy contests during the sample period. To prevent redundancy, only the first contest was used for calculating the dollar value impact on SBA holdings.**

## Average **Absolute** 1, 3, and 5 Year Performance Impact of SBA Voting Decisions when the **SBA supports Management or Dissident,** comparing whether they were the Contest Victor




**Using average returns versus dollar value impact ensures that large market cap companies don't skew the results: the pre vs. post performance of companies is better when the party supported by the SBA wins the contest. Significantly lower returns are observed subsequently when SBA voting decisions are in the minority, in all time periods; this suggests there may be incremental value in SBA voting decisions.**



# **Analysis**: Impact of Supporting or Opposing Management

## Management vs. Dissident Support

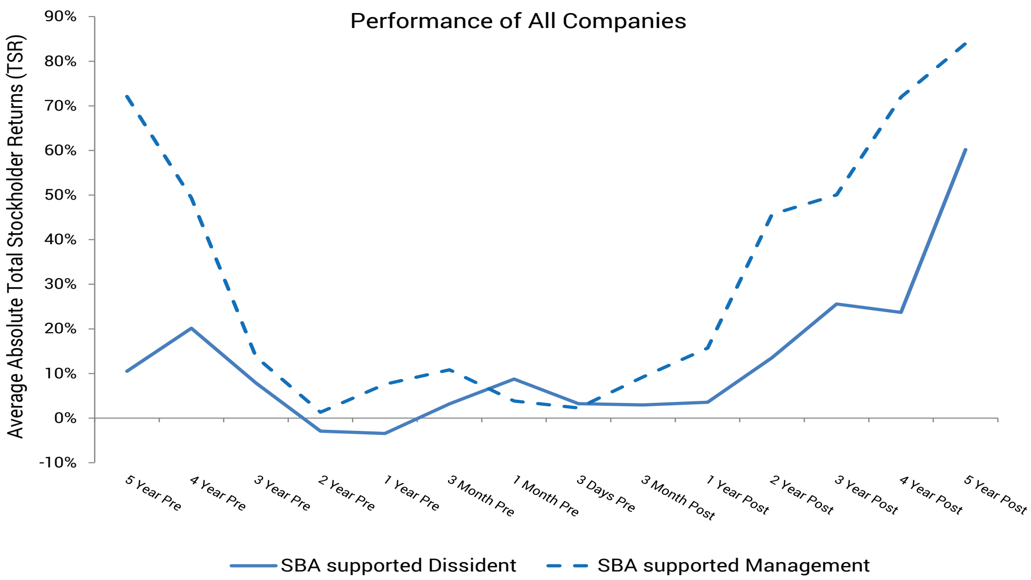
Returns varied based on whether SBA opposed or supported management. We define "oppose" as a situation in which SBA supports at least one shareowner director nominee, or in the absence of a board of director election, supports at least one shareowner proposal. We define "support" as a situation in which SBA supports all of management director nominees and proposals. For the entire sample, SBA opposes management about 65 percent of the time (70 out of 107 situations).

Regardless of who prevailed in the proxy contest, supporting management delivered higher average returns than opposing management. However, considering dissidents are more likely to gain investor support at firms with significantly lagging historical performance, the frequency of SBA voting support increases as well.

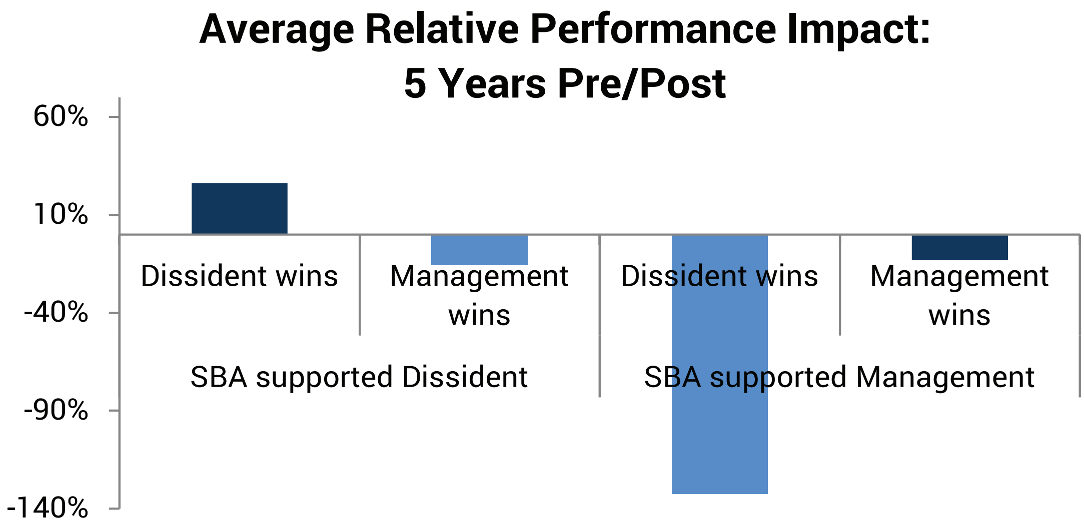
For all firms, returns improved in the one-to-five year periods following the start of the activist project, compared to the one-to-five year period before the activist project.

**.67%**

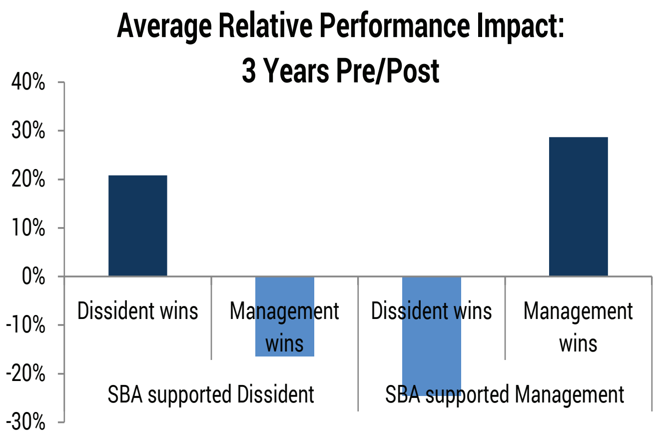
Management has a small lead over the dissidents in the average 5-year cumulative relative returns after a proxy contest, though both lag peers. Management's return of -3.68% only slightly outperforms the average dissident return of -4.35%.

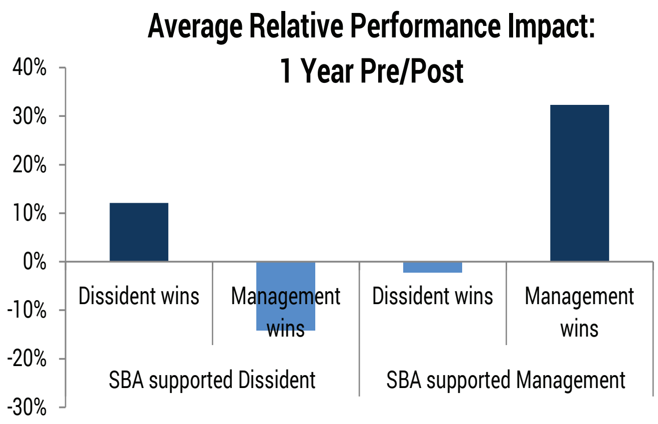


## Average **Relative** 1, 3, and 5 Year Performance Impact of SBA Voting Decisions when the **SBA supports Management or Dissident,** comparing whether they were the Contest Victor




**Industry-relative performance measures show the same pattern, while controlling for timing of the events: the party supported by the SBA has better performance on average in all time periods.**



# Case Studies: Reviews of Individual Proxy Contest Votes and Post-Contest Performance

**Although this study examines a large group of proxy contests, individual company scenarios can also be informative and guide SBA staff when analyzing future events.**

## Career Education Corporation

Example of SBA supporting the contest victor but detracting portfolio value:

In early February of 2006, Steve Bostic, the company's largest individual shareowner, announced a campaign to nominate a slate of three directors to the board of directors at the company's 2006 annual investor meeting. In a letter to the board, he outlined disappointment with the company's board and management's failure to restore the company's damaged reputation, to quickly enhance the quality of its educational service standards, and address the regulatory and operational problems experienced by the company. As noted by FactSet SharkRepellent's activism profile, "At the company's 2005 annual meeting, Mr. Bostic sponsored, and shareholders approved by greater than 60 percent margins, three shareholder proposals to a.) declassify the board; b.) grant 33.33 percent shareholders the right to call special meetings; and c.) eliminate the company's poison pill. Additionally, Mr. Bostic sponsored a "withhold vote" campaign, leading to over 60 percent of the votes withheld from management's director nominees." In response to the 2005 proxy vote, the board accelerated the expiration of its poison pill and announced it would submit two management proposals intended for approval by investors during the 2006 annual meeting; one would be a phased-in declassification of directors' staggered terms and the other would permit 66.67 percent shareowners to call special meetings.

**This section highlights several companies and the associated circumstances that were present during their proxy contest and factors that may have affected their subsequent financial performance. We also touch on the methods that the SBA employs to exercise its voting responsibility on the composition of the board of directors, proposals to amend or change corporate bylaws, and in a proxy contest.**

**These issues are explored in detail by reviewing the SBA's approach to voting in following proxy contests: Steve Bostic's proxy contest at Career Education Corporation in 2006, Sherborne Investors' proxy contest at Nautilus in 2007, The Children's Investment Fund (TCI) and 3G Capital Partners' (3G) proxy contest at CSX Corporation (CSX) in 2009, and Starboard Value's proxy contest at Darden Restaurants in 2014.**

The company also implemented a change in its voting procedure, moving away from plurality voting in uncontested elections to a majority of votes cast and simultaneously adopted a majority vote/director resignation policy. Unhappy with the companies response, Mr. Bostic nominated himself as well as James E. Copeland, Jr. and R. William Ide to stand for election in early 2006. In opposition, the company's management countered with its recent strong financial performance and progress the company had made on a number of fronts, including enhancing corporate governance policies and practices, adding three independent members to the Board of Directors, achieving favorable rulings on two pending legal matters, and making positive progress on regulatory issues. At the time, major proxy advisors viewed management's recent improvements as too little-too late, providing backing to Mr. Bostic's efforts to gain board seats. In its analysis, ISS stated that "management has not gone far enough in addressing the

**In addition to the advice of investors and consultants, the SBA conducts its own review of the corporation when deciding on how to vote its shares.**

shareholder mandate and serious issues remain to be resolved" and that "election of the dissident nominees would bring credibility, accountability, and additional oversight to the board in navigating the company through these regulatory issues and to further improve the company's governance practices."

In May of 2006, Career Education's largest shareowner, Ariel Capital Management, LLC (with a 13 percent ownership stake), announced it had voted its shares in favor of the company's proxy and all management nominees. Other large shareowners, including Fidelity Investments and Barclays Global Investors (now Blackrock) also supported management. At the May 18, 2006 annual shareowner meeting, all of management's nominees were re-elected, receiving 40 percent more votes than the dissident slate. Shareowners also approved the phased-in board declassification proposal and proposal to allow 66.67 percent shareowners to call special meetings. By the middle of June, Mr. Bostic had announced he sold his 1.1 percent stake in the company.

The SBA voted to support the dissidents and opposed the incumbent board, but the company won all 3 of 3 the seats up for election to the 9 member board. The company announced a new compliance committee to cover ethics, federal and state regulatory matters related to education, and accreditation issues.

Since the activist's filing date in early February 2006, Career Education Corporation's stock has declined by over 85 percent through March 31, 2015, severely under-performing both the S&P 500 index (by over 172 percent) and trailing the return of the S&P Education Services sub-industry by over 43 percent.

## Nautilus

Example of SBA supporting the contest victor and adding value:

On July 26, 2007, Sherborne Investors Management LP filed a 13D with the SEC to disclose an ownership stake of 19.9 percent in Nautilus, Inc. In a series of meetings, Sherborne discussed the possibility of joining the board with several directors and members of the management team, as well as to discuss the company's operations, turnaround plans, and the ongoing search for a permanent CEO. In September, Sherborne requested the board call a special meeting of investors to vote for the election of new directors. As noted by the FactSet SharkRepellent database, Sherborne "disclosed that it was unable to reach an agreement with the nominating committee on board composition and would seek to replace four current directors with four new independent directors.

Sherborne would also attempt to amend the company's bylaws to fix the number of seats on the board at 7 and remove the board's ability to increase its size, and to provide that any vacancies on the board may only be filled by shareholders." In October, the company's Chairman and Interim CEO offered to appoint one of Sherborne's two nominees, but Sherborne declined to accept and intended to proceed with a special meeting. Later that same month, the board adopted a poison pill with a 20 percent trigger and a three year term, which effectively locked Sherborne in at its ownership stake of 25 percent. The two leading proxy advisors recommended that investors support some of Sherborne's director nominees. Glass, Lewis & Co. recommended investors elect two dissident nominees, stating "It appears that most of the Company's actions were taken only after [Sherborne Investors] threatened a proxy contest and following many months of disappointing results." At the December 18, 2007 special meeting, all four of Sherborne nominees were elected to the board and its bylaw amendments

**The complete SharkRepellent activist campaign database exhibits an average 3-month excess return of 2.2 percent, relative to an industry sector benchmark for each company in the sample, measured from the start date that it assigns to each situation. Longer time period returns improve with a one-year cumulative excess return of 3.4 percent, 5.9 percent over two years, and 7.1 percent over three years.**

(Continued on Page 22)

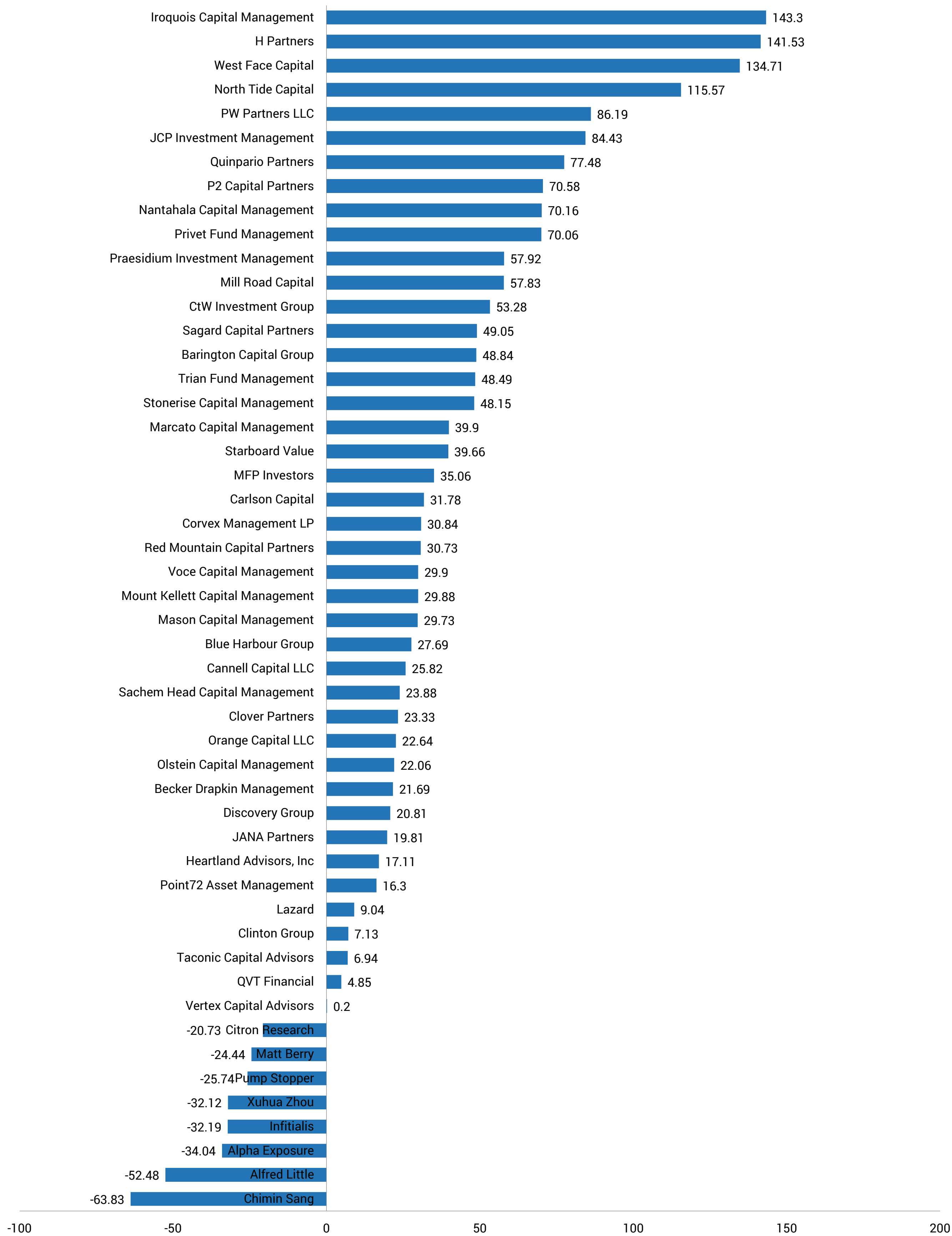
## Activist Fund Campaigns, by Year and Type of Action

### January 2010 through May 2015

| Type of Action | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | TOTAL |
|---|---|---|---|---|---|---|---|
| **Balance Sheet Activism** | **24** | **30** | **49** | **96** | **72** | **30** | **301** |
| Share Repurchase | 12 | 15 | 21 | 41 | 28 | 18 | 135 |
| Dividends | 4 | 7 | 12 | 25 | 18 | 4 | 70 |
| Sell/Retain Assets | 2 | 2 | 7 | 9 | 11 | 3 | 34 |
| Excess Cash | | | 1 | 9 | 7 | 1 | 18 |
| Restructure Debt | 4 | 1 | 5 | 4 | | | 14 |
| Return Cash to Shareholders | | | 3 | 5 | 2 | 2 | 12 |
| Equity Issuance | 2 | 4 | | | 2 | 1 | 9 |
| Recapitalization | | 1 | | 3 | 2 | | 6 |
| Oppose Equity Issuance | | | | | 2 | 1 | 3 |
| **Board Related Activism** | **122** | **117** | **186** | **260** | **311** | **199** | **1195** |
| Gain Board Representation | 97 | 91 | 134 | 174 | 229 | 140 | 865 |
| Removal of CEO or other Board member | 11 | 13 | 40 | 42 | 35 | 20 | 161 |
| Change Board Composition | 6 | 5 | 5 | 23 | 23 | 19 | 81 |
| Eliminate Staggered Board | 6 | 5 | 1 | 13 | 7 | 6 | 38 |
| Separate Chairman & CEO | 2 | 2 | 1 | 3 | 9 | 2 | 19 |
| Board Independence | | 1 | 2 | 5 | 5 | 4 | 17 |
| Elect Director | | | 2 | | 3 | 6 | 11 |
| Oppose Proxy Contest | | | 1 | | | 2 | 3 |
| **Business Strategy** | **5** | **7** | **35** | **66** | **83** | **38** | **234** |
| Business Focus | 2 | 3 | 4 | 17 | 33 | 23 | 82 |
| General Cost Cutting | | | 11 | 18 | 12 | 8 | 49 |
| Business Restructuring | 1 | 1 | 14 | 12 | 10 | 1 | 39 |
| Operational Efficiency | | | 4 | 9 | 8 | | 21 |
| Focus on Growth Strategies | | 2 | 2 | 5 | 8 | 2 | 19 |
| Replace Management | 2 | 1 | | 2 | 6 | 2 | 13 |
| REIT / MLP Conversion | | | | 1 | 6 | 2 | 9 |
| Closure of Business Unit | | | | 2 | | | 2 |
| **M&A Activism** | **52** | **61** | **111** | **114** | **129** | **52** | **519** |
| Push for Sale of Company to third Party | 10 | 21 | 50 | 30 | 51 | 20 | 182 |
| Spin-off/sale of business division | 3 | 6 | 22 | 30 | 28 | 8 | 97 |
| Takeover Company | 13 | 13 | 10 | 16 | 9 | 3 | 64 |
| Oppose takeover terms | 8 | 9 | 12 | 11 | 9 | 8 | 57 |
| Push for Merger of Company with third Party | 11 | 4 | 11 | 6 | 17 | 6 | 55 |
| Oppose Terms of Merger | 2 | 4 | 1 | 5 | 2 | 2 | 16 |
| Push for Company Division | | | 2 | 4 | 7 | 2 | 15 |
| Oppose merger | 3 | 2 | 1 | 3 | 2 | 1 | 12 |
| Push for acquisition of third party | 1 | 1 | 2 | 2 | 4 | 1 | 11 |
| Oppose acquisition of third party | 1 | 1 | | 7 | | 1 | 10 |
| **Other** | | | **3** | **2** | **5** | **6** | **16** |
| Cancel Contract | | | 2 | 1 | 1 | 5 | 9 |
| Push for/Oppose merging of shares | | | 1 | 1 | 3 | | 5 |
| Transfer Listing | | | | | 1 | 1 | 2 |
| **Other Governance** | **5** | **11** | **28** | **18** | **34** | **11** | **107** |
| Redemption/Amendment of Poison Pill | 3 | 6 | 16 | 10 | 9 | 1 | 45 |
| Amend Bylaw | 1 | 1 | 3 | 2 | 13 | 9 | 29 |
| Adopt Majority Vote Standard | 1 | 1 | 3 | 4 | 5 | 1 | 15 |
| Lack of/Inaccurate information from Company | | 1 | 6 | 1 | 7 | | 15 |
| Nepotism | | 1 | | | | | 1 |
| Replace Auditor | | | | 1 | | | 1 |
| Succession Planning | | 1 | | | | | 1 |
| Remuneration | 1 | 2 | 13 | 20 | 18 | 12 | 66 |
| **Grand Total** | **209** | **228** | **425** | **576** | **652** | **348** | **2438** |

Source: Activist Insight, all data as of May 5, 2015, since inception on January 1, 2010.

## Ranking of Top 50 Activist Funds - Sorted By Average Percentage Change Over Total Period of Investment




Source: Activist Insight, all data as of May 5, 2015, since inception on January 1, 2010.

**When examing the immediate 1, 3 and 5 year periods just after the activist's campaign, Nautilus' share price performance did not improve whatsoever, and underscores the longer time frames required to turn around significantly under-performing companies.**

were also approved. By March of 2008, Sherborne had announced the appointment of a new CEO at the company.

Over the study's entire time frame, and since the activist's campaign inception in late 2008, Nautilus' stock has increased by over 193 percent through March 31, 2015, strongly outperforming both the S&P 500 index (by over 130 percent) and many of its peer companies. However, when examining the immediate 1, 3 and 5 year periods just after the activist's campaign, Nautilus' share price performance did not improve whatsoever, and underscores the longer time frames required to turn around significantly under-performing companies.

## CSX

Example of SBA supporting the contest victor and adding portfolio value:

The investment strategy that ultimately culminated in a proxy contest between the railroad company, CSX, and activist hedge funds The Childrens' Investment fund ("TCI") and 3G, began in the latter part of 2006 when TCI began to investigate investment prospects in the U.S. railroad industry. After analyzing and comparing companies across the railroad industry, TCI determined that CSX had trailed the performance of its peers as based on key measures, such as operating margin, free cash flows, return on invested capital, and productivity. Moreover, TCI claimed that CSX's positive performance in regards to its stock price was a result of general market forces, not as a result of the performance of CSX's management team. TCI also wanted to see better corporate governance structures at CSX, which included a change to the company's bylaws that allowed shareowners to call a special meeting. TCI believed that it could engage with CSX management to improve operational, financial, and governance performance of the company, thereby increasing the returns to TCI and ultimately, to all of CSX's shareowners.

While TCI certainly had its eye on affecting change at CSX at the beginning of its investment in the company, TCI did not initially intend to pursue a proxy contest with CSX. Instead, TCI contacted CSX in November 2006 to notify it of its initial and growing ownership interest in the company, and the hedge fund requested a meeting with CSX's management on November 14, 2006. In its discussions with CSX, TCI explained its position in regards to CSX's under-performance and listed changes that the company should implement to increase shareowner value. CSX disagreed with TCI's position and refused to implement TCI's proposals because it held that the company's stock had improved dramatically under its

### Activists and Company Size

Since 2010, activist funds have often pursued inefficiently priced small-cap stocks, perhaps due to their added potential for return and the opportunity to accumulate significant stakes in these smaller businesses at discounted prices. Almost 30 percent of investments tracked by Activist Insight are aimed at small-cap firms, compared with just 10 percent at large-cap firms.

However, among the largest and most experienced activist funds, there is a clear trend toward the allocation of investments into larger firms. The number of large-cap activist targets have almost quadrupled since 2010, with over 100 targeted in 2014 alone. Although the rise can be partly explained by the general boom in activism over the past five years, large-cap targets have also grown the most proportionately compared with other market-cap segments.

The growth in the number of large-cap stocks targeted may also be a result of rising assets under the control of activist hedge funds. Of the 27 most active funds, assets under management have increased by $85 billion since 2012, leaving ample capacity for larger investments and bigger future campaigns.

Source: Activist Insight, May 2015

**Portfolio value can be added or detracted, regardless of which side is the proxy contest victor.**

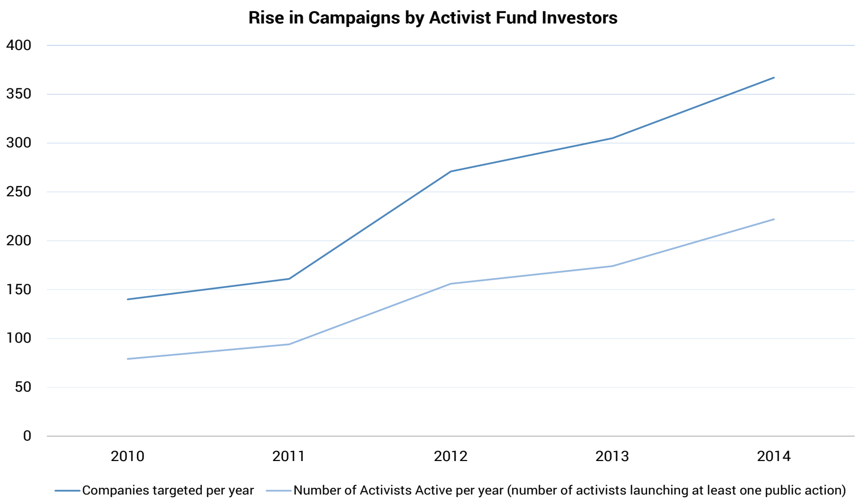
then relatively new CEO, Michael Ward. Accordingly, the relationship between the two entities quickly soured, with TCI further increasing its investment in CSX, with a peak ownership of nearly fifteen percent of the company. On its own initiative, 3G first focused on the U.S. railroad industry as an investment option in late 2006 and early 2007, making its first investment in CSX in early February 2007, purchasing 1.7 million shares of CSX's common stock and then increasing its position in CSX to just under five percent of the firm's total shares outstanding.

Since CSX communicated to TCI and 3G that it would not succumb to their demands, TCI and 3G prepared to battle CSX's perceived intransigence through a proxy contest. As early as April 2007, TCI approached potential candidates to run on a dissident slate of a board of directors; however, TCI and 3G finalized their slate of dissident candidates in the late autumn and early winter of 2007.

At approximately the same time that the entities were finalizing their dissident slate of candidates to run for the CSX board of directors, TCI, 3G, and their candidates (Group) filed a Schedule 13D on December 19, 2007 with the SEC, declaring that they had formed a "group" for purposes of Section 13(d). On January 8, 2008, the Group filed a "Stockholder Notice of Intent to Nominate Persons for Election as Directors of CSX Corporation," (Notice). Realizing the cost and effort that an effective proxy contest requires, CSX board member, Edward J. Kelly, III met with TCI's founder and managing partner, Christopher Hohn, on January 17, 2008, to bridge the differences between the parties. However, the chasm separating CSX and the Group proved too wide, and the Group amended its Notice on January 21, 2008. On February 22, 2008, CSX filed its preliminary proxy statement with the SEC. The Group followed suit with its own preliminary statement on March 10, 2008. Following these initial filings, CSX and the Group, combined, filed over forty proxy solicitations throughout the proxy contest. In an attempt to stymie the Group's efforts, CSX filed a claim against the Group in the U.S. District Court for the Southern District of New York on March 17, 2008. The Group subsequently filed counterclaims against CSX and its chairman, president, and CEO, Michael J. Ward.

SBA staff relied upon all of its voting resources in evaluating the proxy contest at CSX and the Group's positions: internal voting policies, external advice from proxy voting and governance research firms, proxy statements of the parties, discussions with CSX management, the legal case, and media coverage of the contest. The SBA has constructed voting policies that guide its voting decisions as a diligent investor, and the SBA uses these policies in accordance with the laws of the state in which a company is incorporated. The SBA recognizes the importance of voting for board of director candidates in its voting guidelines because members of a company's board of directors serve as the shareowners' elected representatives in overseeing a company. Additionally, barring extraordinary circumstances, shareowners must issue some type of majority vote to remove a member of a company's board of directors. Furthermore, shareowners may vote against a member of the board only at the expiration of that member's term, which may be annually, biannually, or staggered.

In the first proposal of its proxy statement, the Group listed its dissident slate of directors and their qualifications, and it urged voters to elect all five dissident directors. The Group stated that it believed four of five proposed directors would improve CSX's operations because these four individuals had significant experience in the transportation industry, and the Group's fifth nominee would provide a needed "shareowner perspective" on CSX's board of directors. The Group also urged voters to support several




Source: Activist Insight database

## SBA staff relied upon all of its voting resources in evaluating the proxy contest at CSX: internal voting policies, external advice from proxy voting and governance research firms, proxy statements of the parties, discussions with CSX management, legal cases, and media coverage of the contest.

favored CSX nominees. Other ballot items related to shareowner ability to call special meetings, with both incumbent management and the Group advocating their own views.

In addition to their initial proxy solicitations, CSX and the Group filed over forty complementary proxy statements that outlined their different perspectives. Most of these statements focused on the operational and financial performance of CSX. Furthermore, the parties developed websites or added content to existing websites arguing their positions. Overall, the parties spent millions of dollars arguing their respective positions. Interestingly, the parties shared the same strategy for the company; however, their proposed means for achieving the strategy differed significantly. As such, the analyses and recommendations of the SBA's proxy voting services provided much needed third-party perspectives.

As part of the proxy contest analysis, the SBA reviewed the historical track records of the dissident candidates and CSX's incumbents. Incumbent directors, whom the Group had targeted for removal, had an average tenure of fifteen years as members of CSX's board of directors, and during these fifteen years, CSX's stock performance had performed worse than its peers. Additionally, none of CSX's incumbents had any direct railroad industry experience. In fact, the entire CSX board lacked railroad experience except Mr. Ward, the CEO, and Mr. McPherson, whom CSX put forth as a board nominee during the 2008 proxy contest. One of the SBA's proxy advisors compared CSX with Canadian National ("CN") railroad, where Mr. Lamphere served as a director from 1998 until 2005, concluding that CN had outperformed CSX in many financial and operational metrics, including EBIT margin, ROE, Return on Capital, Free Cash Flow Return on Capital, Operating Ratio, Expense Control, train velocity, dwell time, and safety.

To gain additional insight into the positions of CSX and the Group, the SBA participated in a number of face-to-face meetings and conference calls with representatives from the competing sides. Our first meeting occurred on May 9, 2008, at the SBA's offices. David Baggs, Vice President of Investor Relations, Oscar Munoz, Chief Financial Officer, and Michael Ward, Chief Executive Officer, attended the meeting on behalf of CSX. The SBA staff questioned CSX's leadership on a number of issues related to the proxy contest specifically and CSX's corporate governance and corporate performance issues generally, such as the experience of CSX's director nominees versus the experience of the dissidents' nominees, CSX's views on the Group's business proposals, CSX's executive compensation practices, CSX's intentions of separating the company's chairperson of the board of directors position from the CEO position, and the bylaw proposals on special shareowner meetings.

For its entire stock holding, the SBA voted in favor of all of CSX's nominees except three; abstaining from voting on two and withholding support from another. The SBA voted in favor of two of the dissident candidates. Based on all of the information presented, SBA staff determined that these two individuals brought much needed railroad experience to CSX's board of directors. Additionally, the SBA voted in favor of the Group's proposal to amend the bylaws to allow shareowners holding fifteen percent of CSX's voting stock to call a special meeting without the conditions imposed by CSX's proposal. The SBA favored this proposal because it did not limit shareowners' right to vote, and it increased potential accountability for CSX's board of directors. Since the SBA voted for the dissident bylaw amendment on special shareowner meetings, then we also voted to repeal the bylaw amendment on special shareowner meetings that CSX's board of directors had previously adopted.

Since the SBA voted for some of the incumbent candidates and some of the dissident candidates, the SBA is said to have "split" its vote. Vote splitting is unusual in proxy voting. Prior to 1992, SEC rules virtually precluded vote splitting despite state laws permitting it. In 1992, the SEC amended Rule 14a-4(d), the "Bona Fide Nominee" rule, because the SEC acknowledged that the old rule unnecessarily constrained shareowners from exercising their full voting rights. If the CSX vote had been an all or nothing vote as would have been the case under the old SEC Rule 14a-4(d), then the SBA likely would have voted the entire dissident slate, which would have possibly eroded more of CSX's incumbent board of directors than it did. Virginia law, under which CSX was incorporated, allowed such a procedure because it requires that a corporation's directors be elected by a plurality and that shareowners may vote by written ballot and submitted electronically. This procedure allowed the SBA to vote individual nominees among both the dissident and management director pools.

Since the activist's significant investments in early 2007, CSX's stock has increased by close to 250 percent through March 31, 2015, almost doubling the return of the S&P 500 index and far outpacing its industry peers.

**Since the activist's significant investments in early 2007, CSX's stock has increased by close to 250 percent through March 31, 2015, almost doubling the return of the S&P 500 index and far out-pacing its industry peers.**

## Darden Restaurants

Example of SBA supporting the contest victor and adding portfolio value:

Through most of 2014, Darden had been in a constant battle with activist investors regarding its leadership, operations of restaurants, and performance. In late September 2013, Barington Capital Group sent a letter urging Darden's board to consider splitting into two or three companies, while monetizing real estate assets. Darden's board, in response to the letter, formed a "transaction committee" and hired Morgan Stanley and Goldman Sachs as financial advisors. In late December of 2013, Darden announced its strategic plan to enhance shareowner value, including its intention to separate the company's Red Lobster business. A few days later a second activist investor, Starboard Value, filed a 13D indicating its belief that management's turnaround plan still fell short of what would be optimal.

On March 10, 2014, Darden filed a Form 10 registration with the SEC in connection with the Red Lobster separation. Ten days later, Starboard filed definitive materials to solicit written consent of shareowners to call a special meeting, at which it would make a non-binding proposal requesting the board not execute any Red Lobster sale or separation prior to the 2014 annual meeting without shareowner approval. The proposal was supported by 57 percent of shareowners. Despite the high level of support provided by investors not to execute the spin—off, the Darden board of directors instead moved forward without a shareowner meeting and sold Red Lobster to Golden Gate Capital for $2.1 billion on May 16, 2014. Darden's executive team and board hailed this as a victory for shareowners in an effort to unlock value and turnaround the company.

Shareowners, especially activist investors, were not pleased with the deal nor the actions of the board to side-step a requested shareowner meeting. As a result, Starboard increased pressure on the company. Starboard Value immediately released a public letter criticizing the transaction, and on May 21, 2014, Starboard nominated 12 individuals for election to the Company's board. On July 28, 2014, Darden announced that Mr. Clarence Otis would be stepping down as Chairman and CEO. Mr. Otis agreed to continue serving as CEO until the earlier of the appointment of his successor or December 31, 2014. At the time, the company also announced that it had amended its corporate governance policies to provide for the separation of the chairman and CEO roles.

On August 28, 2014, Darden announced that it was rescheduling the annual meeting to October 10, 2014, in order to ensure that shareowners had adequate time to review the proxy materials and make informed decisions at the annual meeting. The SBA supported the request for a shareowner meeting to discuss the sale of Red Lobster and its real estate assets, and the SBA sought an open dialogue with Darden and Starboard throughout the process. SBA staff continued to review the company's actions and performance and examining several hundred pages of detailed proxy and investor documents prior to making an informed decision regarding the proxy fight.

On September 12, 2014, Starboard Value released its 294 page detailed transformation plan for the company, including a specific turnaround plan for Olive Garden. The company issued a statement regarding Starboard's plan expressing its belief that many of Starboard's ideas were already being implemented across the Company and beginning to show results. One of the SBA's proxy advisors, Glass, Lewis &

**October 2014 - SBA staff voted to support the full dissident slate of director nominees proposed by Starboard Value. Based on the SBA's policies, as well as several quantitative, qualitative, and governance metrics of Darden's historical trends and forward looking thesis, staff came to the conclusion that a new business approach and changed top leadership was needed to improve the company's long-term performance and governance practices.**

**The SBA is a direct investor in a Starboard Value portfolio.**

**Throughout the analysis, SBA staff engaged in conversations with Darden's management and board, fund staff at Starboard Value, as well as Starboard's director nominees prior to casting the proxy vote.**

Co., recommended that its investor clients vote in favor of 12 dissident nominees, stating that, "Ultimately, we believe that the need for change at Darden has been well established and that this contest boils down to determining which slate of directors is best-suited to oversee Darden through this transformational period. In light of the Company's long term loss of shareowner value and the board's governance practices and irresponsiveness to shareowners, we believe Starboard has made a compelling case that election of all of its nominees is warranted. Our review of the individual qualifications, experience and track records of all candidates causes us to believe that the election of the Dissident slate is more likely to affect long-term improvements and provide greater board oversight."

On October 7, 2014, the SBA voted 561,482 shares (or 0.4235 percent of the company's total shares) in favor of replacing the entire board of directors. The SBA also voted in favor of shareowner proposals to provide a new proxy access mechanism, additional political or lobbying disclosures, and the firm's say-on-pay ballot item. Throughout the analysis, SBA staff engaged in conversations with Darden's management and board, fund staff at Starboard Value, as well as Starboard's director nominees prior to casting the proxy vote. In a nearly unprecedented move, investors voted to replace the entire board with the 12 individuals on the dissident's slate. The results were called "extraordinary" in the business press and reflected the dissatisfaction that investors felt toward a board that refused to heed its will. The board has never been swept at such a large company before, and this could serve as an ominous precedent for future boards who choose to ignore strong investor sentiment. Since the proxy contest took place, Darden's stock has risen by 31 percent through March 31, 2015, far out-pacing both the S&P500 index (by over 22 percent) and almost doubling the return of the S&P Restaurant sub-industry.

## Data Visualization

To complement the study, SBA staff created interactive charts using data visualization software (Tableau).

Click ***here*** to see the interactive features of the data.

Or go to the following URL:

https://public.tableau.com/views/FloridaStateBoardofAdministrationSBA-ActivistFundVotingStudy2015/Story1?:embed=y&:showTabs=y&:display_count=yes

## Descriptive Statistics of Company Sample and Analysis

Statistical analysis of the data provides an important check on the validity of our conclusions. We have performed an analysis of the 1-year absolute and relative returns for the companies in the sample, factoring in contest outcome in some cases, in order to arrive at the conclusion that there is some differential information and value in the voting recommendations as made by SBA staff.

By breaking the companies into groups based on whether SBA supported management of not, and observing the one-year absolute or relative returns after the candidate, we found statistically-significant patterns which are echoed in the discussions and graphs above. When SBA supports management and management wins, the performance after the contest is good, comparatively. But when the market outcome of the vote is different than the SBA's vote, the future returns are much lower. We conducted similar tests on these company-groups in the period before the contest to ensure that the groups were not just characteristically different, and we found no difference in the returns between the groups before the contest. This suggests that perhaps these are cases where the wrong team "won", and both absolute and relative underperformance ensued.

A similar relationship was observed in cases where the dissident won, by breaking those sample companies into groups based on whether the SBA supported the dissidents or not. Although the data was not statistically significant for these cases, it was close to that threshold (using a 5 percent alpha, typical in academic research), and the data was directionally suggestive of the same pattern.

In addition to suggesting the wrong team may have "won", this may suggest either that management is more likely to subsequently underperform than the dissidents after winning an election wherein SBA has not supported their election, or it may suggest that our binary treatment of "dissident support" may need some further parsing for clearly identifying relationships. In later reports and analysis, we may choose to analyze the data so that "supporting the dissident" can be more refined, such as on the proportion of dissidents supported (rather than, as we have done in this analysis, merely classifying dissident support as voting for at least one member of the dissident slate). In either case, the analysis implies SBA voting may be a better indicator of future performance than the market in general.

Despite having 107 companies in our sample, the limited number of firms with longer time-horizon returns data makes it difficult to perform detailed statistical analysis of all time periods for the data at this point in time. Since our sample period runs from 2006 through 2014, many firms simply do not have a full 3 or 5 years' worth of returns, leaving subsample groups that are too small in count for reliable statistics. We do plan to augment this analysis when greater data is available, in addition to extending the sample period, in a later report.

The results of one test conducted on before and after 1-year, absolute returns in contests won by management is shown below.

ABSOLUTE RETURNS 1-YEAR PRIOR TO CONTEST

t-Test: Two-Sample Assuming Unequal Variances

| | *Where Mgmt wins & SBA supported* | *Where Mgmt wins & SBA did not support* |
|---|---|---|
| Mean | 0.062146657 | 0.08634243 |
| Variance | 0.618820128 | 0.140590263 |
| Observations | 21 | 22 |
| Hypothesized Mean Difference | 0 | |
| df | 28 | |
| t Stat | -0.127775006 | |
| P(T<=t) one-tail | 0.449620157 | |
| t Critical one-tail | 1.701130934 | |

ABSOLUTE RETURNS 1-YEAR POST CONTEST

t-Test: Two-Sample Assuming Unequal Variances

| | *Where Mgmt wins & SBA supported* | *Where Mgmt wins & SBA did not support* |
|---|---|---|
| Mean | 0.280606648 | -0.06024525 |
| Variance | 0.600443079 | 0.210184685 |
| Observations | 21 | 22 |
| Hypothesized Mean Difference | 0 | |
| df | 32 | |
| t Stat | 1.745175348 | |
| P(T<=t) one-tail | 0.045275958 | |
| t Critical one-tail | 1.693888748 | |

# Voting Dataset - Proxy Contests from January 1, 2006 through December 31, 2014. (Page 1 of 4)

| PROXY CONTEST (COMPANY) | DATE | DISSIDENT | WINNER | SBA "WIN" | SBA OPPOSED MGMT? |
|---|---|---|---|---|---|
| Career Education Corporation | 2/10/2006 | James E. Copeland, Jr.<br>R. William Ide<br>Steve Bostic | Management wins | lose | oppose |
| H. J. Heinz Company | 3/3/2006 | Gregory J. Norman<br>Michael F. Weinstein<br>Peter H. Rothschild<br>Sandell Asset Management Corp.<br>Trian Fund Management, L.P. | Dissident wins | win | oppose |
| **Arbinet Thexchange** | 3/15/2006 | Governing Dynamics Investments LLC<br>Robert A. Marmon<br>Thai Lee | Dissident wins | win | oppose |
| Massey Energy Co. | 3/16/2006 | Third Point LLC | Dissident wins | win | oppose |
| infoGROUP Inc. | 3/29/2006 | Dolphin Limited Partnership I, L.P. | Management wins | lose | oppose |
| Arrow Intl Inc | 6/15/2006 | Robert W. Cruickshank | Management wins | lose | oppose |
| Yardville Nat'L Bancorp | 6/23/2006 | Seidman and Associates, LLC | Dissident wins | win | oppose |
| Esmark | 7/17/2006 | Esmark Incorporated<br>Franklin Mutual Advisers, LLC | Dissident wins | win | oppose |
| Cyberonics, Inc. | 9/11/2006 | Metropolitan Capital Select LLC<br>The Committee for Concerned Cyberonics, Inc. Shareholders | Dissident wins | win | oppose |
| Caremark Rx Inc. | 12/18/2006 | Express Scripts, Inc. | Management wins | win | support |
| Motorola Solutions, Inc. | 1/30/2007 | Icahn Associates Corp. | Management wins | lose | oppose |
| Atmel Corporation | 3/15/2007 | George Perlegos | Management wins | lose | oppose |
| Hexcel Corporation | 4/27/2007 | OSS Capital Management LP | Management wins | win | support |
| Topps Co | 5/30/2007 | Crescendo Advisors LLC | Management wins | lose | oppose |
| CBOT Holdings Cl A | 6/12/2007 | IntercontinentalExchange, Inc. | Management wins | win | support |
| H&R Block, Inc. | 6/27/2007 | Breeden Capital Management LLC | Dissident wins | win | oppose |
| Quality Systems, Inc. | 7/30/2007 | Ahmed Hussein | Dissident wins | lose | support |
| Nautilus, Inc. | 8/24/2007 | Sherborne Investors Management LP | Dissident wins | win | oppose |
| CSX Corporation | 10/16/2007 | 3G Capital Partners Ltd. (Private Equity)<br>Gary L. Wilson<br>Lamphere Capital Management<br>TCI Fund Management (UK) LLP<br>Timothy O'Toole | Dissident wins | win | oppose |
| Datascope Corp | 10/18/2007 | David Dantzker<br>Starboard Value LP<br>William J. Fox | Dissident wins | win | oppose |
| A. Schulman, Inc. | 10/22/2007 | Starboard Value LP | Dissident wins | win | oppose |
| Consolidated-Tomoka Land Co. | 10/23/2007 | Western Investment LLC | Dissident wins | lose | support |
| Charming Shoppes | 1/15/2008 | Crescendo Advisors LLC<br>Myca Partners, Inc.<br>The Charming Shoppes Full Value Committee | Dissident wins | win | oppose |
| Media General Inc. | 1/25/2008 | Harbinger Capital Partners | Dissident wins | win | oppose |
| Phoenix Companies, Inc. | 1/28/2008 | Carl Santillo<br>John B. Clinton<br>Oliver Press Partners LLC | Dissident wins | win | oppose |
| GenCorp Inc. | 1/31/2008 | Steel Partners, L.L.C. | Dissident wins | win | oppose |
| Silicon Graphics International Corp. | 2/29/2008 | Richard L. Leza, Jr. | Management wins | lose | oppose |
| Office Depot, Inc. | 3/17/2008 | Levitt Corporation | Management wins | lose | oppose |
| Grubb & Ellis Co. | 6/26/2008 | Sharon Thompson<br>Thompson National Properties, LLC | Management wins | win | support |
| **Federal Signal Corporation** | 6/30/2008 | Warren B. Kanders | Management wins | win | support |
| Biogen Idec Inc. | 8/11/2008 | Icahn Associates Corp. | Dissident wins | lose | support |

# Voting Dataset - Proxy Contests from January 1, 2006 through December 31, 2014. (Page 2 of 4)

| PROXY CONTEST (COMPANY) | DATE | DISSIDENT | WINNER | SBA "WIN" | SBA OPPOSED MGMT? |
|---|---|---|---|---|---|
| International Rectifier Corporation | 8/15/2008 | Vishay Intertechnology, Inc. | Management wins | lose | oppose |
| NRG Energy, Inc. | 10/19/2008 | Exelon Corporation | Management wins | win | support |
| Amylin Pharmaceuticals Inc. | 11/3/2008 | Eastbourne Capital Management LLC | Dissident wins | win | oppose |
| PHH Corporation | 11/25/2008 | Pennant Capital Management LLC | Dissident wins | lose | support |
| Online Resources Corp. | 12/23/2008 | Tennenbaum Capital Partners LLC | Dissident wins | win | oppose |
| Chemed Corporation | 2/12/2009 | MCM Management, LLC | Management wins | lose | oppose |
| Providence Service Corporation | 2/23/2009 | Avalon Correctional Services, Inc. | Management wins | win | support |
| CF Industries Holdings, Inc. | 2/25/2009 | Agrium Inc. | Dissident wins | win | oppose |
| ORBCOMM Inc. | 3/24/2009 | Committee to Realize Value for ORBCOMM<br>John C. Levinson<br>Michael Miron<br>Steven G. Chrust | Management wins | win | support |
| Emulex Corporation | 4/21/2009 | Broadcom Corporation | Management wins | lose | oppose |
| Children's Place, Inc. | 4/24/2009 | Ezra Dabah<br>Renee Dabah | Dissident wins | lose | support |
| Saks Incorporated | 4/28/2009 | P. Schoenfeld Asset Management LP (New York) | Dissident wins | win | oppose |
| Myers Industries, Inc. | 5/29/2009 | GAMCO Asset Management Inc. | Management wins | win | support |
| Barnes & Noble, Inc. | 11/13/2009 | The Yucaipa Cos. LLC | Management wins | lose | oppose |
| Agilysys, Inc. | 1/22/2010 | Starboard Value LP | Dissident wins | win | oppose |
| Biogen Idec Inc. | 1/28/2010 | Icahn Associates Corp. | Dissident wins | win | oppose |
| Airgas, Inc. | 2/5/2010 | Air Products and Chemicals, Inc. | Dissident wins | lose | support |
| Presidential Life Corp. | 2/16/2010 | Herbert Kurz | Management wins | win | support |
| Genzyme Corp. | 2/22/2010 | Icahn Associates Corp. | Dissident wins | lose | support |
| Denny's Corporation | 3/2/2010 | Dash Acquisitions, LLC<br>Lyrical Asset Management LP<br>Murano Partners LP<br>Oak Street Capital Management LLC<br>Soundpost Partners LP<br>The Committee to Enhance Denny's | Management wins | lose | oppose |
| **Pinnacle Entertainment, Inc.** | **3/22/2010** | **AFL-CIO** | **Management wins** | **win** | **support** |
| **Ameron International Corporation** | **3/30/2010** | **Barington Companies Investors LLC** | **Dissident wins** | **win** | **oppose** |
| **MCG Capital Corporation** | **4/6/2010** | **Western Investment LLC** | **Management wins** | **win** | **support** |
| **Casey's General Stores, Inc.** | **4/9/2010** | **Alimentation Couche-Tard Inc.** | **Management wins** | **lose** | **oppose** |
| **Dynegy Inc.** | **10/21/2010** | **Seneca Capital Advisors LLC** | **Dissident wins** | **lose** | **support** |
| **Pulse Electronics Corporation** | **12/28/2010** | **Bel Fuse Inc.** | **Management wins** | **win** | **support** |
| **Fisher Communications, Inc.** | **1/27/2011** | **FrontFour Capital Group LLC** | **Dissident wins** | **lose** | **support** |
| **Mentor Graphics Corporation** | **2/3/2011** | **Alberta Investment Management Corp.<br>Casablanca Capital LP<br>Element Capital Advisors Ltd.** | **Management wins** | **lose** | **oppose** |
| **Capital Gold Corp Com New** | **2/10/2011** | **Timmins Gold Corp.** | **Management wins** | **win** | **support** |
| **Leap Wireless International, Inc.** | **3/10/2011** | **Pentwater Capital Management LP** | **Dissident wins** | **win** | **oppose** |
| **Forest Laboratories, Inc.** | **6/13/2011** | **Icahn Associates Corp.** | **Management wins** | **lose** | **oppose** |
| **Cracker Barrel Old Country Store, Inc.** | **6/13/2011** | **Biglari Capital Corp.** | **Management wins** | **win** | **support** |
| **Benihana Inc.** | **6/22/2011** | **Benihana of Tokyo, Inc.** | **Dissident wins** | **lose** | **support** |
| **Oshkosh Corp** | **6/30/2011** | **Icahn Associates Corp.** | **Management wins** | **win** | **support** |
| **Regis Corporation** | **8/16/2011** | **Starboard Value LP** | **Dissident wins** | **win** | **oppose** |
| **AMAG Pharmaceuticals, Inc.** | **9/22/2011** | **MSMB Capital Management LLC** | **Dissident wins** | **win** | **oppose** |

# Voting Dataset - Proxy Contests from January 1, 2006 through December 31, 2014. (Page 3 of 4)

| PROXY CONTEST (COMPANY) | DATE | DISSIDENT | WINNER | SBA "WIN" | SBA OPPOSED MGMT? |
|---|---|---|---|---|---|
| ModusLink Global Solutions, Inc. | 9/29/2011 | Locksmith Capital Management LLC<br>Peerless Systems Corporation | Dissident wins | win | oppose |
| Myers Industries, Inc. | 11/4/2011 | GAMCO Asset Management Inc. | Management wins | win | support |
| Quality Systems, Inc. | 11/10/2011 | Ahmed Hussein | Dissident wins | lose | support |
| Mac-Gray Corporation | 11/14/2011 | Moab Capital Partners LLC | Dissident wins | win | oppose |
| AOL Inc. | 12/21/2011 | Starboard Value LP | Management wins | lose | oppose |
| Illumina, Inc. | 1/24/2012 | Roche Holding AG | Management wins | win | support |
| Progress Software Corporation | 1/24/2012 | Starboard Value LP | Dissident wins | lose | support |
| Comverse Technology Inc. | 3/28/2012 | Cadian Capital Management LLC | Dissident wins | win | oppose |
| Sigma Designs, Inc. | 3/28/2012 | Potomac Capital Management LLC | Dissident wins | win | oppose |
| Cracker Barrel Old Country Store, Inc. | 4/19/2012 | Biglari Capital Corp. | Management wins | win | support |
| BMC Software, Inc. | 5/14/2012 | Elliott Management Corporation | Dissident wins | win | oppose |
| Forest Laboratories, Inc. | 5/30/2012 | Icahn Associates Corp. | Dissident wins | win | oppose |
| Clearwire Corporation Class A | 6/1/2012 | Crest Financial Limited | Dissident wins | win | oppose |
| Biota Pharmaceuticals, Inc. | 6/29/2012 | Mangrove Partners | Dissident wins | win | oppose |
| Office Depot, Inc. | 9/17/2012 | Robert L. Nardelli<br>Starboard Value LP<br>T-S Capital Partners, LLC | Dissident wins | win | oppose |
| International Game Technology | 1/7/2013 | SpringOwl Associates LLC | Dissident wins | win | oppose |
| PLX Technology, Inc. | 1/25/2013 | Potomac Capital Management LLC | Dissident wins | win | oppose |
| Hess Corporation | 1/28/2013 | Elliott Management Corporation | Dissident wins | win | oppose |
| Cracker Barrel Old Country Store, Inc. | 2/15/2013 | Biglari Capital Corp. | Management wins | lose | oppose |
| Myers Industries, Inc. | 2/21/2013 | GAMCO Asset Management Inc. | Dissident wins | lose | support |
| Mac-Gray Corporation | 3/6/2013 | Moab Capital Partners LLC | Dissident wins | win | oppose |
| DSP Group, Inc. | 3/8/2013 | Starboard Value LP | Dissident wins | win | oppose |
| Morgans Hotel Group Co. | 3/18/2013 | OTK Associates, LLC | Dissident wins | win | oppose |
| Alere Inc. | 5/8/2013 | Coppersmith Capital Management, LLC<br>Scopia Capital Management LLC | Management wins | lose | oppose |
| MGP Ingredients, Inc. | 5/24/2013 | Cray Group | Dissident wins | lose | support |
| Morgans Hotel Group Co. | 6/20/2013 | Kerrisdale Advisers LLC | Dissident wins | win | oppose |
| Sotheby's Class A | 8/26/2013 | Third Point LLC | Dissident wins | win | oppose |
| Bob Evans Farms, Inc. | 9/24/2013 | Sandell Asset Management Corp. | Dissident wins | win | oppose |
| Griffin Land & Nurseries, Inc. Class A | 11/25/2013 | GAMCO Asset Management Inc. | Management wins | lose | oppose |
| Superior Industries International, Inc. | 11/25/2013 | GAMCO Asset Management Inc. | Management wins | win | support |
| Spark Networks, Inc. | 12/6/2013 | Osmium Partners LLC | Dissident wins | | oppose |
| Graftech International Ltd | 1/23/2014 | Daniel Milikowsky<br>Nathan Milikowsky | Dissident wins | win | oppose |
| Pantry, Inc. | 1/23/2014 | Concerned Pantry Shareholders<br>JCP Investment Management LLC<br>Joshua Schechter<br>Lone Star Value Management, LLC | Dissident wins | win | oppose |
| Cliffs Natural Resources Inc. | 1/28/2014 | Casablanca Capital LP | Dissident wins | lose | support |
| Endeavour International Corporation | 2/10/2014 | Talisman Group Investments, L.L.C. | Management wins | lose | oppose |
| Sensient Technologies Corporation | 2/19/2014 | FrontFour Capital Group LLC | Management wins | lose | oppose |
| CONMED Corporation | 2/25/2014 | Coppersmith Capital Management, LLC | Dissident wins | lose | support |
| Anworth Mortgage Asset Corporation | 3/28/2014 | Western Investment LLC | Management wins | win | support |
| Darden Restaurants, Inc. | 5/2/2014 | Starboard Value LP | Dissident wins | win | oppose |

## Voting Dataset - Proxy Contests from January 1, 2006 through December 31, 2014. (Page 4 of 4)

| PROXY CONTEST (COMPANY) | DATE | DISSIDENT | WINNER | SBA "WIN" | SBA OPPOSED MGMT? |
|---|---|---|---|---|---|
| **Chiquita Brands International, Inc.** | **8/15/2014** | **Grupo Safra SA<br>Sucocitrico Cutrale Ltda.** | **Dissident wins** | **win** | **oppose** |

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