

**LAWNDALE**  
CAPITAL MANAGEMENT, LLC

***Activist Shareholder Dialogue***

***Andrew Shapiro***

***Directors Forum 2010***

***Shareholder Hot Topics Panel***

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**For further information contact:**

**415-389-8258**

**[aeshapiro@lawndalecap.com](mailto:aeshapiro@lawndalecap.com)**

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## Introduction

Directors are Shareholder's agents

- oversee the business affairs of the corporation
- hire, task, oversee, hold accountable and, when necessary, replace senior day-to-day management.

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## Most Directors Are Unlikely to Interact With Activists

- Persistent Operational or Stock Price Stagnation/Deterioration
- Extraordinary Corporate Events and Capital Allocation

## Activists Are Institutional Monitor or Catalyst

“Boards of directors are like subatomic particles, they behave quite differently when under observation.” - Nell Minow

Boards who are either sleepy or co-opted need to wake up or be reformed.

Seize the agenda, be pro-active or go down in flames

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## Strategy: Target Evaluation

- Requirements: 1) Dirt cheap valuation; 2) Underperformance is improvable
- Determine the problem, for example:

### Symptom

### Improvable Problem

- |  |        |                                    |
|--|--------|------------------------------------|
| – Low ROA  | —————→ | Poor Capital Allocation            |
| – High ROA/Low ROE                                     | —————→ | Poor Capital Structure             |
| – High Operating Expenses<br>(relative to peers)       | —————→ | Cost/Compensation Control          |
| – Stock Underperformance<br>(relative to fundamentals) | —————→ | Poor Disclosure/Investor Relations |

- Dysfunctional corporate governance?
  - Good boards recognize these issues and take action
- Can an active owner be the catalyst to force necessary change and unlock value?

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## Extraordinary Corporate Events and Capital Allocation

- Selling the Company (LBO / MBO / Third Party)
  - Independent Committee
  - Full and Fair Auction
  - Reasonable Deal Protections ( no shop, break-up fee, etc)
- Capital Deployments
  - Build (R&D) vs. Buy (Product/Segment/Whole Company)
  - Capital allocation trade-off with stock repurchase/dividend
  - Price paid and subsequent integration

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## Hierarchy of Activism

<ul style="list-style-type: none"><li>• Formation of Views</li></ul>	<ul style="list-style-type: none"><li>• Analyzing and Voting of Proxies</li><li>• Active Questioning on Company Conference Calls and at Annual Meetings</li></ul>
<ul style="list-style-type: none"><li>• Communication of Views</li></ul>	<ul style="list-style-type: none"><li>• Private Communication of Your Viewpoints with Management and the Board of Directors</li><li>• Public Dissemination of Your Viewpoints</li></ul>
<ul style="list-style-type: none"><li>• Increase Shareholder Value <u>with</u> Management / Board Cooperation</li></ul>	<ul style="list-style-type: none"><li>• Proactively Assist Company Achieve Strategic Goals and Overcome Obstacles</li><li>• Board Representation (Indirect/Direct; Voting Member/Observer; Minority/Majority)</li></ul>
<ul style="list-style-type: none"><li>• <b>ALTERNATIVELY</b> Increase Shareholder Value <u>without</u> Management / Board Cooperation</li></ul>	<ul style="list-style-type: none"><li>• Proxy Actions (Vote No Campaign; 14(a)(8) Shareholder Proposal; 14(a)(4) Proxy Contest: Bylaw Amendments, Board Representation (see above))</li><li>• Shareholder Inspection of Company Documents</li><li>• Court Actions (Appraisal Rights; Shareholder Derivative Suits; Class Action Suits)</li></ul>

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## Optimal Director

- Active - Engaged
- Qualified - Knowledgeable
- Independent - not just by technical definition

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## Dialogue With Shareholders

- Duty of Care - Includes *duty to be informed*
- Entirely relying on management for information is recipe for trouble
- Director/Shareholder meeting
  - Reg FD easily satisfied - conference call / webcast
  - Compensation - Accountability of grantors, not recipients
  - Shareholder nominations of director candidates

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## Compensation

- Pay for performance
  - Not for sticking around but rewarding true performance
  - Restricted stock vs. Options
  - Options
    - Duration - does not have to be 10-years!
    - Post exercise holding period on stock
  - Golden Parachutes/Golden Coffins
    - Payment for failure to perform - IRS Sec 162(m)
  - Clawback rights for restatements

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## Imperial CEO

- Combined Chairman/CEO vs. Split Roles (Independent Chairman)
  1. Emboldens/Enables culture of independence in Boardroom
  2. Lowers Aggregate Compensation costs
  
- Transition Process
  1. Defrocking for Performance Reasons
  2. Hire new leader for CEO role only

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## Examples of Activism

- MDT Corp - “Vote No” campaign changed board; opposition to tender offer resulted in 22% bump
- Nu West Preferred - Influenced restructuring creating 5x jump; force redemption of preferred (1996) and Delaware Supreme Court victory re: increasing redemption proceeds and compounding of interest (2001)
- Live Entertainment - Block ownership of preferred influenced restructuring and sale for control premium
- Bally’s Grand - Publicly supported shareholder derivative lawsuit and appraisal action
- United Coasts - Delaware Appraisal Rights suit resulting in a 19% premium to takeout price
- Executone Information Systems - Called for breakup - “parts worth more than the whole”
- OroAmerica - Relational IR support; supported buyback leading to repurchase 6.5% of outstanding
- Quality Systems - Ousted founder, Chairman/CEO, largest shareholder; replaced 6 out of 7 directors; set strong corporate governance precedent
- High Plains - QSII corporate governance bylaw; destaggered board; delayed tendering of shares pushing substantial gain into next tax year
- Arlington Hospitality - Supported alternative director slate, elected Vice Chairman, oversaw auctioning of company via §363 bankruptcy sale to quash lease liability and maximizing residual value
- New Valley Corp - Opposed majority shareholder’s initial takeover bid and negotiated 17% premium
- Mercer International - Forced destaggering board during 2006 reincorporation
- National Home Health Care - Opposed LBO with rival bidder & appraisal rights leading to 20% price bump
- Earl Scheib - Served as Board Observer 2003-04; Nominated director in late 2007 leading to 2009 sale
- Mace Security - Proxy fight led to new directors, governance reforms & new CEO. Turnaround in progress.
- Sparton Corporation - 2008 Proxy fight added directors; 2009 turnaround team and plan delivering already.

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