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Activism At Banks - Conference Call Transcript

U.S. Banks

Attached is the edited transcript for our Nov 7th conference call on Activism at Banks. A few summary points follow:

- **Activists can make a difference.** The main point of our subject matter expert on activism (Ken Squire of 13D Monitor) is that activist investors can help narrow the valuation gap for undervalued stocks. As it relates to Citigroup and Sallie Mae (two companies discussed), the mere threat by activist ValueAct can help motivate managements to better focus on value creating businesses vs. those that destroy value.
- **The threat of tough action is sometimes enough.** The risk of a proxy fight is often sufficient to engage with a board and management, especially since activists' interest are often aligned with most other shareholders. For example, ValueAct (one of the more successful activists) has gained board seats in about half their positions but has had to engage in only one significant proxy battle (with Acxiom in 2006) to gain board representation. Since then, per our speaker, ValueAct typically only needs to take a large public position in a company to engage with its board and management. That seems akin to the story about Bill Russell not wanting to throw an elbow at an opponent, but Coach Red Auerbach encouraged him to do it once on national television and he would never need to throw another elbow again.
- **Bank activism at Citigroup is possible.** Activism at banks is easier with a healthier industry (vs. a decade ago), according to Ken Squire, and it's easier at smaller banks that don't have the same resources to defend themselves. ValueAct has a $1B stake in Citigroup given the bank's structurally lower risk profile and chronic underperformance (relative to potential), which create significant value creation opportunities when engaging with Citi's management and board.
- **Sallie Mae**. ValueAct was likely attracted to SLM (8.6% stake) given that it is a misunderstood business largely given negative perceptions from its former business of providing government-backed student loans. However, today they are focused on fully underwritten private student loans with very healthy credit characteristics including 90% co-signer rate (typically with a parent), average FICO of ~750 and ~1% net loss rates. With the underlying infrastructure of a larger company, there is opportunity for further operating leverage as the loan portfolio grows. It would not be surprising if ValueAct ultimately becomes a board member and they could add value around areas such as SLM's expansion into personal loans and credit cards.
- **Activist investors have less investments than the perception.** Activist value investors typically take long positions (aligned with most other shareholders) and engage with management to influence financial results by improving governance, strategic positioning, and/or operations. Despite the headlines, activist funds represent around 1% of industry hedge funds (about 100 out of 10,000) and less than 5% of industry AUM ($160B out of $3.3T).

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Transcript – Activism at Banks

Mike Mayo: Welcome to today's call on activism at banks. I'm Mike Mayo, large cap bank analyst. With me is Don Fandetti, consumer finance analyst and Michael Kaye, mid cap consumer finance analyst. We are all with Wells Fargo Securities. Our guest speaker today is subject matter expert, Ken Squire.

Ken founded 13D Monitor; that's the only qualitative institutional research service in activism. He hosts the largest conference on activism, runs the largest mutual fund that invests in activist situations, and knows the players, the activists, mutual funds, banks, law firms, proxy solicitors. Ken is the nexus of information and analysis in the activist world.

Ken will speak for 15 minutes. We'll follow up with questions from our team here at Wells Fargo Securities and then we'll take general Q&A. And we do appreciate your questions. By the way, we'll have an extra focus on Citigroup and SallieMae, given the roll of activists in those firms. So Ken, what can you tell us about activism in banks? And thanks for joining us.

Ken Squire: Thank you, Mike, and thanks to Wells Fargo for having me today. There are slides, but you're not going to need the slides. If you want to follow along, great. If not, you'll be able to follow anyway. To start, I want to talk a little bit about shareholder activism for those of you that might not be as well versed in it. Shareholder activism is basically value investing where the investor is a catalyst in closing the valuation gap.

Most shareholder activism is done through 13D filings. 13D is an SEC filing where a shareholder buys more than five percent of a company and intends to influence management. He must file the 13D within 10 calendar days of exceeding five percent and must file an amendment if he increases or decreases the position by one percent. Amendments are generally filed within two business days. A lot of media confuses what is and what isn't shareholder activism.

To be a shareholder activist, there's really three main components. One, the activist has a long position. Two, the activist intends to influence management. And three, the activist's interest are generally aligned with the other shareholders. What isn't shareholder activism is shortselling. Herbalife, for instance, is not shareholder activism even if an activist is the one taking the short. Or when a shareholder files a 13D and makes an offer to buy the company when his interests are clearly not aligned with the other shareholders, but counter to them. That also we don't consider shareholder activism.

Types of activism -- on the second slide, if you're following along, corporate governance. This is where ValueAct lives, which is going to be a big part of this call today. That's basically coming on, getting board seats and trying to help create value from a board level. Strategic activism with M&A, selling subsidiaries, doing roll ups. This is a type of activism we've seen a lot of in a low interest rate environment. Operational activism, which you tend to see more of in higher interest rate environments, that's coming in and changing management or more of an income statement type of activism where you're trying to work with margins and the bottom line.

And finally, financial activism, which is the activism that generally gives somewhat of a bad name, in some sense, to activism, which is the buyback of shares, special dividends. We rarely see this type of activism anymore on its own. It's generally part of a broader activist plan. 10, 12 years ago you used to see activists come in, lever up the company and buy back shares, which really is the short term type of activism that has gotten a bad name.

What is the value proposition in activism? We believe, as do many, that it's an understandable, repeatable, non-correlated way to outperform or to get alpha. Basically activists are closing the valuation gap. So if you have -- as an example, if you have two companies, let's say they're trading at $10 a share and you believe both of their companies have an intrinsic value of $20 a share, the company that has an activist in it is probably going to get to that intrinsic value earlier than the other company.

So it's a way to close the valuation gap quicker. Another way of looking at it is all companies trade on a pretty efficient risk curve that's based on management's public plan and public information and you'll buy or sell on that curve based on your belief on management's ability to execute. Activists don't invest on that curve. They come in with a different plan that if they're right, puts the company on a different curve. They believe a better return curve. And that curve is not public information until the activist comes out with their plan.

And to the extent they're right, they get a better return scenario. And essentially what they're offering these shareholders is they're not forcing their plan down management; the activists can't get anywhere without the support of shareholders, so they're basically offering an option for shareholders between their plan and management's plan. The next slide, which is the size of the market.

You hear about activism all day on CNBC, and the Wall Street Journal seems to cover it ad nauseam, but it surprises a lot of people that activist hedge funds make up less than one percent of total funds, less than five percent of total assets, and most importantly, fewer than three percent of public companies are engaged by an activist each year.

So while it might get a lot of publicity, it's really still a small niche where activists are really going against the companies that they think they can create the most value. We included a slide on ValueAct's history. It's impossible to read. We just want to show you the breadth of the number of 13Ds they filed in their history. And then we included an easier to read slide, more detailed slide on their activist history in financial companies.

Now I want talk a little bit about ValueAct before we get into Citigroup. ValueAct is truly a behind-the-scenes activist. They're immensely respected amongst institutional investors and in boardrooms probably more so than any other activist. They take board seats in about half of their portfolio positions. They have a very deep bench of analysts and partners who go on different boards. They are bottoms up stock pickers who have a relatively long-term focus, so they'll want to be in a position for 5 to 10 years, and they do not care as much about short term returns if they see long term value.

And a really good example of this is when they took a position in Adobe many years ago, when Adobe was about to move from a purchase model to a subscription model. ValueAct took that position knowing that revenues were going to decrease, knowing that margins were going to be compressed, but they thought that they could actually be helpful to management in giving them cover with other shareholders and vocally supporting management's plan to move to a subscription model, which was very helpful.

But most importantly -- and you'll see this theme through what we talk about the rest of this call -- ValueAct likes companies that they believe are misunderstood by the market.

So before we talk about Citi there's a couple of other companies that I think are relevant to Citi that will show what we mean. They took a position in Morgan Stanley recently -- a year or so ago. They love Jim Gorman and they were all on the same page when they met with management.

Again, this is a company they believed is misunderstood by the market. It was viewed as a trading, lending and banking company but wealth management comprised half of the company's earnings. ValueAct likes highly visible businesses with recurring revenue and an unfair competitive advantage. They saw this in Morgan Stanley's wealth management business. Wealth management was a growing business with no real capital requirement; however management was not investing in this business, trying to grow it or even talking about it.

Because relevant to trading and banking, it was perceived as not sexy. ValueAct's offense plan at Morgan was to invest in this business, grow it and talk about it as a unique platform and growing business.

So as we say, ValueAct had an offensive plan at Morgan to invest in the wealth management business, grow it and talk about it as a unique platform and growing business, but they also had a defensive plan, which was to fix the rest of Morgan's business, namely the trading and lending businesses, which comprised 80 percent of the company's book value but only 20 percent of its earnings.

However, because the environment was so good for trading businesses at the time they never really got around to their defensive plan as trading actually started doing well in that environment and they focused more on the offensive wealth management plan. So that was the Morgan Stanley thesis.

Microsoft I also want to talk about. And believe it or not, ValueAct analogizes Citigroup to Microsoft. I'm going to talk briefly about Microsoft. Again, a misunderstood business. Again, a growing business with steady cash flow and a competitive advantage. That competitive advantage was their business of its server and tool business, which had deep relationships with enterprise users. So they had this deep enterprise server and tool business yet the dialogue was all about PCs and mobile phones. So again, a misunderstood business. ValueAct ended up getting a board seat there and was able to help the company focus on the right part of the business, and they did very well there.

OK, so now let's move on to Citigroup. Citi is an investment that ValueAct would not have made 10 years ago. They believe that the U.S. banking system now has a structurally lower risk profile than any time in recent memory because regulations have made banks less leveraged with higher quality assets. Banks have returned to basic financial services such as safeguarding assets and lending money and the level of speculative financial engineering has pretty much dramatically reduced.

So ValueAct thinks this is a good time to invest in the banking industry. And not only ValueAct. I think over the last 8 to 10 years it's very difficult for an activist to be in these large banks because of those reasons and now I think financials are going to be a little bit more on their radar. As we discussed with the other ValueAct situations, ValueAct believes that Citi is a company that is misunderstood by the market and has a business with steady growth, recurring revenue an unfair competitive advantage.

That business is its institutional, treasury and trade solutions business. This business accounts for almost 70 percent of Citi's profitability but nobody really ever talks about it and the dialogue on Citi is monopolized by credit card business, which generates only 15 percent of its revenue. The treasury and trade business is a truly global business with trading, custody and clearing in 97 markets, which is more than double their nearest competitor.

This has allowed Citi to become the key provider of the financial plumbing for multinational corporations and counts 80 percent of the Fortune 500 as their clients, which in the turn allows Citi to leverage these relationships and get unsexy businesses like bond refinancings. Like with Morgan Stanley and Microsoft, the plan here was to invest and grow and talk about the best businesses, the treasury and trade solutions business, and pull back from or divest in the bad businesses.

The main difference with Citi is that this was a much more complicated situation. Citi is at the tail end of a major restructuring that they quietly exited over 20 global consumer markets and shedded nearly $800 billion in non-core assets. While there might be some divestitures that still need to be done, for the most part management has erased a lot of the distractions and can now focus their energy on growing the core business.

Two tangential opportunities from an activist perspective at Citi are cost cutting and capital allocation, but really the main plan here is focusing on the right businesses. Cost cutting and capital allocation is really not ValueAct's main M.O. when it comes to activism. Yes, they believe that there could be some costs that could be cut that could add some value and they also believe that Citi – the company could return $50 billion to shareholders without impacting earnings growth targets, and then up to $20 billion a year if they chose too. With the way ValueAct looks at this, they target an EPS of at least $10 per share by 2020. So that's Citi.

The last position we're going to talk about – financial position of ValueAct is SallieMae, or SLM Corp. Again, this is a misunderstood company by the market, according to ValueAct. There's a negative perception in the market about government backed or implicitly guaranteed loans like Freddie Mac and Fannie Mae. However, SallieMae has not made government backed loans since 2010, or held government backed loans since 2014, when they spun that business off as Navient Corporation.

Now they just issue private student loans and they actually underwrite them themselves and take on the risk. So they have a heavy portfolio of loans. 90 percent of their loans are cosigned by the parent of the student loan. The average FICO score is approximately 750, and their average loss rate is about one percent. Sallie Mae has a 55 percent market share, but what's interesting is they can show balance sheet and EPS growth without even increasing their market share.

Since the spinoff of Navient, they have a much smaller balance sheet, so keeping the same level of loan origination leads to a much larger growth rate. Additionally, since they still have the infrastructure of a much larger business, most of the new revenue will go right to the bottom line.

So just by maintaining its market share, ValueAct believes SallieMae could achieve a 10 percent compounded annual growth rate to its balance sheet and a 15 percent EPS growth rate each year for the next four years.

At that point, ValueAct could probably become more valuable as an investor by helping them explore strategic opportunities like personal loans or credit cards that allow them to leverage their valuable customer base of students or younger individuals.

That's where ValueAct really can be most helpful by looking at potential strategic opportunities and using their team of analysts to help the board or help management figure out what the best return on investment is.

So that is the SallieMae investment, and with that, I'm happy to open it up to any questions.

Mike Mayo: All right, I can start. By the way, I love your definition of an activist, it's a value investor where the investor is the catalyst to bridge the valuation gap. So could you also say an activist is someone who helps to bridge the governance gap, or the gap between what one would like to have happen vs what actually happens?

Ken Squire: In certain instances, I would not say that so much with ValueAct, because ValueAct generally comes into companies where there's relatively good governance, there's a good management team and ValueAct is basically saying to management you keep doing what you're doing with maybe some certain small changes.

You keep generating cash flow, we're going to help figure out the best way to use the cash flow. But yes, there are activists that come into companies that have horrible corporate governance, entrenched boards, and they come in and there are some companies where I've had some institutional investor clients tell me that the company is un-investable because of management.

And activists look at that as an opportunity, that if they could come in and replace management and instill good corporate governance, shareholder friendly corporate governance, that they could create a lot of value.

So in certain situations, that is the case. I want to go back to one thing though, remember activists are only engaging with three to four percent of public companies. So you ask any activist, they will tell you that 90, 95 percent – 90 plus percent of public companies are run by competent, professional management teams with strong boards. It's really just the bottom five percent that they engage with.

Mike Mayo: Well I'd like to drill down more deeply for both Citigroup and Michael Kaye can do so for SallieMae. So just pull the lens back a little bit. It seems as though the number of cases for activism in banks and financials is a lot less in the general market. Is that the case, and if so, why?

Michael Kaye: Well I think certainly historically it's been the case. Banks are more complicated than a lot of other companies in the market or the average company in the market. It's tough to convey your activist plan to shareholders in banks more so than in a consumer company or a retail company. The markets haven't been right for the past several years for activism in banks.

There's been a lot of uncontrollables, there's been a regulatory cycle and large fines that have really kept activists away. That's starting to settle down. So I do think that the financial system, as I said before, is safer for activists now but it's been something that they've generally stayed away from.

With the exception of their expert activists in some of the smaller regional banks that have done a consistent activism in those areas.

Mike Mayo: All right, let me go to Citigroup then. So you have Ed Garden of Trian on the board of BNY Mellon. I think that's the first activist on a board of a major bank that we've seen. So we're trying to handicap - does ValueAct go on the board of Citigroup? Ken Squire, you're the expert, yes or no?

Ken Squire: At this point, I would say no. I think if you look at Morgan Stanley and you look at Microsoft, they went on the board of Microsoft because they had to. They went on the board of Microsoft because there were changes there that needed to be done that they needed a board seat to do, and that Microsoft might not have been on the same page as them at that point.

Look at Morgan Stanley. I'm sure if Morgan Stanley would have totally disagreed with ValueAct and fought them on their agenda, they might have considered taking a board seat there. But they didn't have to because everything was pretty much agreeable. I think at this point with Citi, it looks like they were all on the same page, and if that continues, I don't think they're going to need to take a board seat there.

But I think if they do take a board seat, it might be a sign that maybe there is a little bit of disagreement.

Mike Mayo: I see, so if they agree and Citigroup's going to execute plans that they think should happen, regardless of who takes credit, then they don't take a board seat.

Ken Squire: I like that – I want to tell you, I like that you say regardless of who takes credit, because I've had so many discussions with ValueAct where they berate me when they see other activists trying to take credit for things that companies do.

ValueAct – not only are they an activist that doesn't care who gets the credit, they almost prefer that management and the boards get the credit for what's done. And it's deservedly so. So they don't like when activists try to take credit, and they don't really like to take credit for things.

Mike Mayo: Well you're kind of not getting me so excited here for a moment, I want you to take the other side. So maybe I'll take a board seat and maybe I'll try to change the governance, and maybe then I'll try to change pay. I mean they're not so focused on cost and capital, so they're just another investor with a billion dollar position and think it's going to go higher.

Ken Squire: Well they're engaging – they're regularly engaging with management, they're talking about what they believe, they're talking about their plan to management and to the extent management is agreeable with their plan, then you're right.

They're probably not that different in this case than any other mutual fund that has a plan that management agrees with. I mean, as you know -- we just saw that they have a new chairman and there's a little issue about the separate roles of the CEO and chairman at Citi versus, maybe JP Morgan.

I will tell you that I'm sure that ValueAct had conversations with the board on that. And while separating the chairman and CEO role is not their soapbox, that's not something that they're going to really go to the mat on. My guess is that they'd prefer in this case to have a separate CEO and chairman.

Mike Mayo: So what if anything separates ValueAct from another large investor, depending on how things progress over the next year or two? I want you to highlight the differences.

Ken Squire: You know a lot of the times, the A in ValueAct should be a small A whereas sometimes it's a big A. They will engage harder if they have to. And that I guess would be the main difference between them and a lot of other shareholders.

Like other shareholders, they're going to monitor it, they're going to keep an eye on it, and they're going to watch the company. But if they see things going awry, or going according to a plan that they don't agree with they'll engage harder and they will go for a board seat. I mean that's pretty much what they did at Microsoft.

Mike Mayo: All right, so what they do is they have the option to go aggressive if things do not go their way, is that correct?

Ken Squire: Right. And many times in the past, they've gotten board seats because a lot of large institutional shareholders, some of them might be on this call -- have discussed with management we like ValueAct, we think they have value -- we would agree to give them a board seat if we were you. And a lot of times they do have some of these institutional shareholders speak up for them.

Mike Mayo: And then, just finishing up on Citigroup here. Based on what we're seen at Citigroup over the last decade, time's up. It seems as though this should be incredibly intense expense control at the company and that you're watching every paperclip. And while Citi's improved a lot we don't the sense they have that sort of intensity that they need.

So one could say to ValueAct, why wait? They haven't gotten the job done, they didn't get the target from 2013. They're on progress for the 2020 targets, but that's with the aid of tax cuts and higher interest rates and more buybacks, things that were partly out of their control. So don't wait, go ahead. Get a board seat now, up that intensity.

Ken Squire: Well, I would answer that ValueAct's well aware, obviously that they've underperformed over the last several years; that they've been slower than their peers to basically unwind from 2008. And I will tell you this, even without a board seat, I would expect that management and the board feels the pressure with ValueAct and ValueAct's level of engagement.

Mike Mayo: Great. Well, let's segway over to Sallie Mae. Michael Kaye?

Ken Squire: Michael, why don't you go ahead with your questions, Sallie Mae?

Michael Kaye: Great, thanks Ken. Looking at ValueAct (13D) filing for Sallie Mae, it notes a very wide range of possible conversation topics. It's fairly broad so it's difficult to decipher what angle they're coming from. So my question is, does ValueAct typically come into a new investment like SallieMae with a specific aspect of the company they're looking to change, whether they simply just see a good value and go from there?

Ken Squire: Generally, unlike many other activists, they're coming into companies that don't require a ton of change. That they see good value, good businesses that they like where they think they can add value as, either, a potential board member or as an active shareholder. And I think that's the case here.

Michael Kaye: OK. And the second question on a similar vein. As you know, they have an 8.6 percent stake in SallieMae. Do you think they ultimately request board representation? And if they do, what kind of board member could we expect? Would they push for aggressive change if they did want to get on the board?

Ken Squire: I wouldn't be surprised if they eventually get a board member here and they ask – they ask for a board member. If it is done it would be done amicably. I'm almost certain, as it is in almost every one of their situations. They don't have to come on the board for aggressive change.

They come on the board where they really think that they can be value – at value by, like I said – when a board is exploring strategic opportunities like going into personal loans, or credit cards, or whatever else it may be it's really good to have somebody in the room that has a team of analysts that can go back and run the models on all of this, and really do a lot of work on the different opportunities, and come back and say what they think would be best for shareholder value. And I think that's a place where ValueAct can really add a lot of value for the company and their shareholders.

Michael Kaye: Great, thanks.

Client 1: Good morning guys. So Ken, just a quick question, you mentioned that there are some activist investor out there that have a special expertise in regional banks. And I'm just wondering if you think that there's anything specifically that gives these managers an edge in the regional bank space versus the large cap banks?

Ken Squire: Give it – well, I think it's like anything else in activism. I don't think that's specific to banks. I think it's a lot easier to create value and change at smaller cap companies than it is at these big large cap companies. You know, one is like turning around a cruise ship, and the other is like turning around a Boston Whaler. It's difficult to expect quick change at the larger cap companies.

A lot of these small regional banks, they don't have the resources of the large companies. These small regional banks have to be lenders. They have to be investors. They have to be consumer people that deal with the clients. They have to be marketers. They don't have the teams that some of these bigger banks do to really have the resources to really do that. So a lot of times these activists come in and say if you can't fix this you should just be acquired by a bigger bank that can, basically, leverage your customer base better. So it's much easier activism in these small cap banks.

Client 1: Got it, thanks.

Mike Mayo: And I saw that you downplayed ValueAct. ValueAct has done proxy fights, correct?

Ken Squire: Well, I would – I don't know if you'd want to use an "s" at the end of that. They did one at Acxiom in 2006. I equate ValueAct to the story I use about ValueAct is when – for any of you basketball fans, or older basketball fans, when Bill Russell was getting eaten up under the boards because he didn't want to be tough under the boards.

Red Auerbach told him to throw one elbow once on national T.V. and he'll never have to throw and elbow again. And that's kind of what ValueAct did with (Axiom). They fought one really hard proxy fight in 2006 and they've never fought one again.

Mike Mayo: Well, once you prove you can do it – it's like the movie Shane, the old western movie.

Ken Squire: Exactly.

Mike Mayo: Once you show it.

Ken Squire: I will tell you also that they did get their board seat at Microsoft the day before the deadline for submitting a director nominee to the board. So I believe had not gotten their director at Microsoft, you would've seen them at least commence a proxy fight at Microsoft.

Mike Mayo: Let's go to Chris Spahr of the Wells Fargo Securities bank team, Chris?

Chris Spahr: Thank you, Mike. So my question is – well, we talked about Citigroup's board, and recently confirmed that the chair and CEO will be split. Does that actually give any benefit to activists? Have you seen any kind of benefits of having that role split, or does it really matter as long as you have an independent lead director?

Ken Squire: So what most activists really care about is having a good CEO, and a good chairman, and if it happens to be the same person like Jamie Dimon, or Warren Buffet, I don't think activists are really going to care.

Splitting the chairman and CEO, getting rid of a staggered board, getting rid of poison pills don't, in themselves, really add value to a company. What does add value is getting rid of the culture that allows for staggered boards, allows for poison pills that aren't approved by shareholders, and allows for a chairman and CEO that's acting more like a dictator than acting like a responsible chairman and CEO.

Again, as I said, this is not ValueAct's soapbox. They are not a big separate chairman and CEO person. They just want to make sure that the company has a good chairman and a good CEO.

Mike Mayo: Before you finish, and I love your phrase there, rid the culture that allows for bad governance because Citi's had bad governance for the century before this decade, as highlighted in several recent books; "Borrowed Time" by James Freeman and "Keeping at it" by Paul Volcker. But is Citi too big for activism? I mean, that's what we had heard from many investors.

Ken Squire: No. I mean, it's not too big for activism at all. I mean, Microsoft wasn't too big for activism, and Citi is not too big for activism. Like I said, it's not as easy, and it's not as quick in a large company like Citi as opposed to a smaller bank or a smaller company. But there's certainly value that can be created. Just like we were talking about. I mean, to the extent ValueAct comes in and betters the corporate governance culture, and makes the company more responsive to shareholders. That should be beneficial on its own.

Mike Mayo: All right, back to Chris Spahr.

Chris Spahr: Yes, thanks. So in a recent merger seminar conference, one issue that was brought up is how entrenched boards are among banks. They tend to be locally – especially for regional banks, they tend to be locally based, along with the banks, and be highly compensated board members, some of the most highly compensated board members in the industry. So how does an activist engage with and entrench boards that might be beholden to the CEO.

Ken Squire: Well, a lot of times activists, like the more entrenched the board, the better the opportunity, right? If you come into a company that's really underperforming and underperforming its peers, has really high margins, is doing everything wrong.

And then you go meet with their board and board says, listen, we're open for anything. We've been talking to shareholders. We'll do whatever is needed, and we've had that attitude for years. There might not be a good opportunity there, but if it's because the board, like you said, is highly compensated. And really running it for themselves as opposed to their shareholders. Those are the best opportunities for activists, and like you also alluded to, also some of the most difficult.

So coming in and changing a corporate culture, and really changing an entrenched board is one the hardest things for activists to do but it is the most rewarding. Now, how did they do it? Again, they come in, they threaten a proxy fight. They commence a proxy fight if needed. They talk to other shareholders.

Generally, in these companies, the shareholders are waiting for an activist. And it's very easy to get the shareholder support. They'll end up getting support of ISS if the board is truly entrenched. And we're at a point now where it's much easier to get rid of entrenched boards than it was 10 years ago.

Mike Mayo: I like that point also. At companies, shareholders are often waiting for an activist. Explain to us what that means? And how does that work? So, there's been some times, frankly, we put out the research on BNY Mellon a few years ago raising the concerns. And as we raise the concerns, we called down the investor list, people said yes. And we sent a letter to the board last week, yes. And that was before there was an activist in the stock. And then you had Trian move in.

So I guess these activists, how do they keep their fingers on the pulse? How do they know that shareholders are upset? That if you're a mutual fund and have a position of stock and it's not working for you, do you pick up the phone and call Carl Icahn? How does that work?

Ken Squire: Well I think that might be a better question for some of the people on this call that have mutual funds. I would answer that saying that yes I do believe that there are some that I know of large institutional investors that will reach out to activists in a position that they feel an activist is needed. I'm not sure there's a lot of large institutional investors that admit that publically but certainly activists are getting much more ideas from shareholders today than they were 10 years ago or even 5 years ago.

Mike Mayo: So another email question. Does a board member have to leave the board before going activist? So I guess, let's say I'm retired, it's 10 years, maybe it's 20 years from now, I'm not sure. My wife won't let me retire. So 20 years from now I'm a board member. It's not working out and I want to take a stake and go activist. Do I have to leave the board before I do that?

Ken Squire: Well there's no reason you would have to leave the board to do that unless you're on the board pursuant to standstill agreement. So often activists get on the board and the standstill agreement will say we will not solicit proxies or do anything adverse but the standstill agreement terminates as of this date or the date we leave the board. So it allows the activist to leave the board and start a proxy fight. For a director that doesn't have a standstill agreement, you can be on the board and have a proxy fight. I'm not so sure you're going to stay on the board very long once you commence a proxy fight. I mean the board might get rid of you themselves. They'll vote you off or however they're allowed to get rid of directors at that specific company but there's nothing that would preclude you from doing that.

Client 2: Last week "The Wall Street Journal" published an article saying Deutsche Bank is now being approached by an activist investor. I was just curious if you had any thoughts on that.

Ken Squire: Yes, we really don't like to even look into speculation and things like that. You know I get calls all the time like do you know who this is? Do you know who that is? And until an activist situation is announced with any credibility we really don't get involved or really look into it that much.

Client 2: Well actually they mentioned that Hudson Executive took a 3.1 stake in Deutsche Bank, at least that's the headline in the "Wall Street Journal."

Ken Squire: The Hudson Executive is an interesting – I'll use the small "a" for activist because we don't really regard them as activist. This is a former banker and CEOs that come together and they have a huge network of public company CEOs that have invested in the fund or that are advisors to them that help them source ideas or help them with their positions once they take them.

So to the extent they have a position in Deutsche Bank, I can't imagine it's going to be anything confrontational. A lot to times they're invited into situations by the companies so they can help the company, get the company covered in implementing a plan that management wants. So they're about as – they're about as least confrontational activists – and again I say that with a small "a" – as you can possibly get.

I wouldn't expect them to be coming in and driving significant change that management doesn't want.

Mike Mayo: If I can intervene here, it's Mike Mayo. I mean, is that the role of activists sometimes anyway? Like management has a plan and activist comes in and the activist simply helps to facilitate a plan management was otherwise going to do but with a little bit more oomph.

Ken Squire: Yes, absolutely. That certainly can be the role of activist like I discussed at Adobe but if the company is in need of significant change, and I'm not saying Deutsche Bank is, but if the company is in need of significant change and the activist is coming in to allow the company to continue to do it's plan that hasn't been working then you don't really see that as an activism.

Mike Mayo: So like at Citigroup, at the conclusion of our report that we published on Citigroup, Citigroup says it has industry-leading efficiency and our conclusion is Citigroup has worst in class efficiency. Now you have a new CFO coming in at Citigroup and the new CFO can say, "Hey let's do these 10 things," and ValueAct agrees and maybe that makes his job easier. Help me with my thinking.

Ken Squire: Yes, well it would make his job easier if ValueAct is out there talking with other shareholders and telling them they support the new CFO and they support the plan. Certainly I think having an activist in there – having ValueAct in there makes management's job easier to the extent that other shareholders can hopefully have some confidence that ValueAct is maybe keeping a little bit more of an engaged eye on management than the other shareholders otherwise would and will, like we said before, if management is going down the wrong path, will get more aggressive and maybe take a board seat.

Mike Mayo: So completing the arc of this discussion - so could perhaps the job of the newer Deutsche Bank CEO be made relatively easier by having this extra support behind the CEO, the network that Hudson Executive has and the headlines and visibility?

Ken Squire: Yes, if I'm correct in that this is an amicable situation and Hudson Executive is on the same page as the Deutsche Bank CEO, yes it could certainly make his job a little bit easier. However I will say that Hudson Executive doesn't have anywhere near the credibility ranking or the respect as an activist that someone like ValueAct does. They're on the other side of the spectrum.

Mike Mayo: All right. I'll take a couple more of the e-mail questions. What about ValueAct's MSCI situation? The situation got ugly, publically, and they ended up appointing three directors to the board. They ended up driving a lot of change there. Stock was at $40 at the time when they invested, and I think it did pretty well. But it got pretty ugly. So describe MSCI.

Ken Squire: So that was a situation where the unique thing to me about this situation, I remember when this happened – and again, this is a 13D that ValueAct exited in 2016. But what happened there was, like you said, ValueAct wanted a board seat, and it's one of the few times where they wanted a board seat and the company says no.

And they ended getting a board seat, because just like I said, a lot of a larger institutional shareholders told the management that they would like to see ValueAct with the board seat. And whether ValueAct would've committed a proxy fight there, we don't know. I'm not so sure.

It's not Microsoft, obviously. It wasn't as big of an investment for them as Microsoft was. But again, they didn't have to because the shareholders spoke out and management heard them.

Mike Mayo: Wait, back up. Visibly ugly, but let's say ValueAct got really angry at the Citi management team. Would we even know? I mean say they're behind the scenes, I guess they're like the quiet activist and all that. So we don't know what's going on. It's kind of black spot.

Yes, there's an activist. Yes, they're probably exerting pressure. Yes, they have the threat of exerting pressure. Your analogy, if you throw an elbow once, the threat of that will perhaps get companies to do things. But we just don't know. Or is there a way to know?

Ken Squire: We would know more if it was a 13D filing. Again, this is not a 13D filing because ValueAct doesn't own more than 5 percent of the company. Obviously, that would be a large investment for them; they would not make such a big investment.

So we don't know. You're right, they can be engaging with the company behind the scenes much more aggressively and – than they could – much more aggressively, much more privately than they could if they were a 13D filer.

Mike Mayo: All right. Ken, I'd like you to give your closing comments. And for your closing comments, what I'd like to know is, why ValueAct is in both Citigroup and Sallie Mae; and that they're different than your traditional large investor because why and why -- give your final punch there.

In other words, some investors get very excited that ValueAct is in Citigroup or Sallie Mae, and others say, "So what? Who cares?" So what I want to hear is why you think it is an incremental positive that ValueAct has these large stakes and the outlook for the stock price.

Ken Squire: ValueAct, first off, the first thing – the reason one should get excited is they do have a history, as do many of the people on this call, I'm sure, as a very good value investor, finding undervalued companies, they have [great] returns since their inception.

So first off, as a value investor, that's a positive sign. But more importantly, as an activist, I always say, the activism you see on CNBC or reading the Wall Street Journal, the sexier activism of proxy fights and selling companies and selling subsidiaries and doing spinoffs, that's not the activism that often generates the best returns.

Often, the best activism over the years has been when a really good activist gets on the board of a really good company and they sit there and they generate returns together and management continues doing what they're doing, and the activist could come help with strategic and shareholder communication type of services.

Now I know a lot of people might not agree at this point, whether Citi is a great company. But I know that ValueAct believes, as do others, that they are at an inflection point after this quiet and large restructuring they've done, getting rid of tons of non-core assets, and that they are at a point now where they can really focus on some of their really strong businesses and become a good company.

So that’s what I expect ValueAct to do at Citi, that’s what I expect for them to do at Sallie Mae and really help, really work as a partner with management to drive shareholder return.

Mike Mayo: That concludes our call with Ken Squire, founder of 13D Monitor, host of the largest conference on activism, and a person who runs the largest mutual fund focused on 13D filings. Ken Squire, thank you for your time today.

[Slide deck on next page]

Slides – Activism at Banks

Shareholder Activism

Ken Squire

13D Monitor & 13D Management

Mason Morfit and Ken Squire at the 2017 13D Active Passive Investor Summit

Source: Ken Squire (13D Monitor)

Universe of Modern Day Activism

What Is Shareholder Activism?

- Value Investing where the Investor is a Catalyst in Closing the Valuation Gap

Components of Shareholder Activism

- The Activist Has a Long Position
- The Activist Intends to Influence Management
- The Activist's Interests Are Aligned with Other Shareholders

Shareholder Activism is Not

- Short Selling
- Shareholders Acquiring a Company

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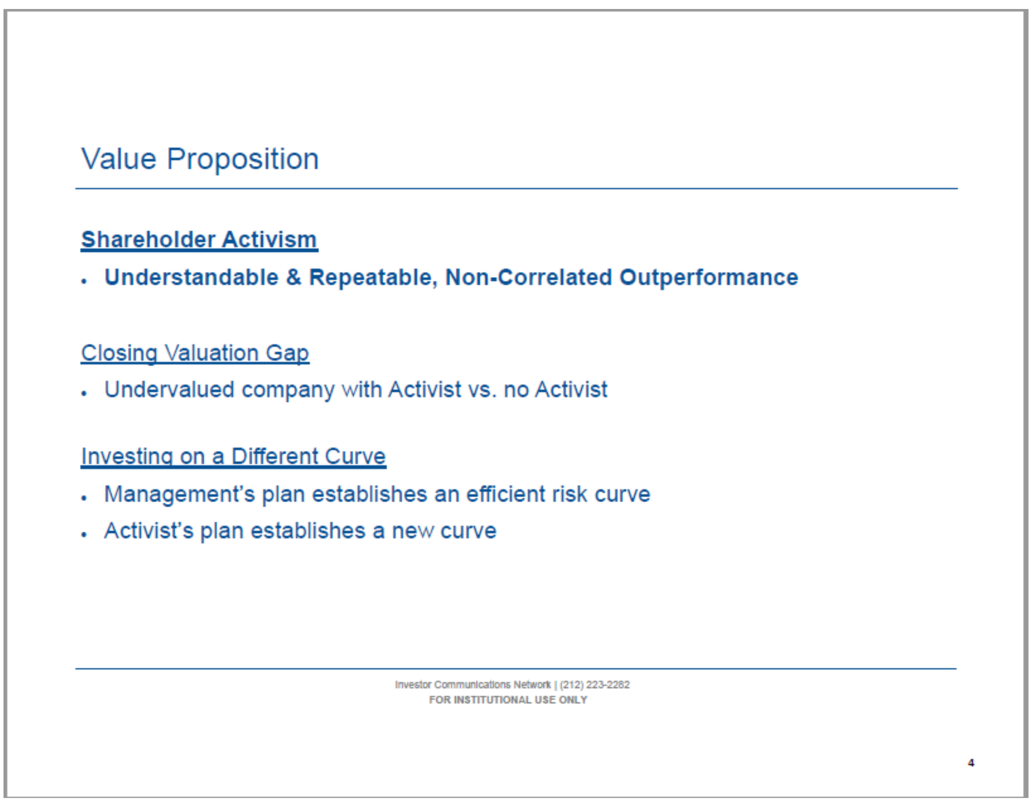
Source: Ken Squire (13D Monitor)

Source: Ken Squire (13D Monitor)



Source: Ken Squire (13D Monitor)

Size of the Market

As of 1/2018	TOTAL HEDGE FUNDS	ACTIVIST HEDGE FUNDS	PERCENTAGE
Number	~ 10,000	~100	~1%
Assets	~$3.3 Trillion	~$160 Billion	< 5%
	TOTAL US PUBLIC COMPANIES	**U.S. COMPANIES TARGETED 2017**	**PERCENTAGE**
Number	~ 4,000	117	< 3%

Sources: 13D Monitor & https://www.barclayhedge.com/research/indices/ghs/mum/HF_Money_Under_Management.html

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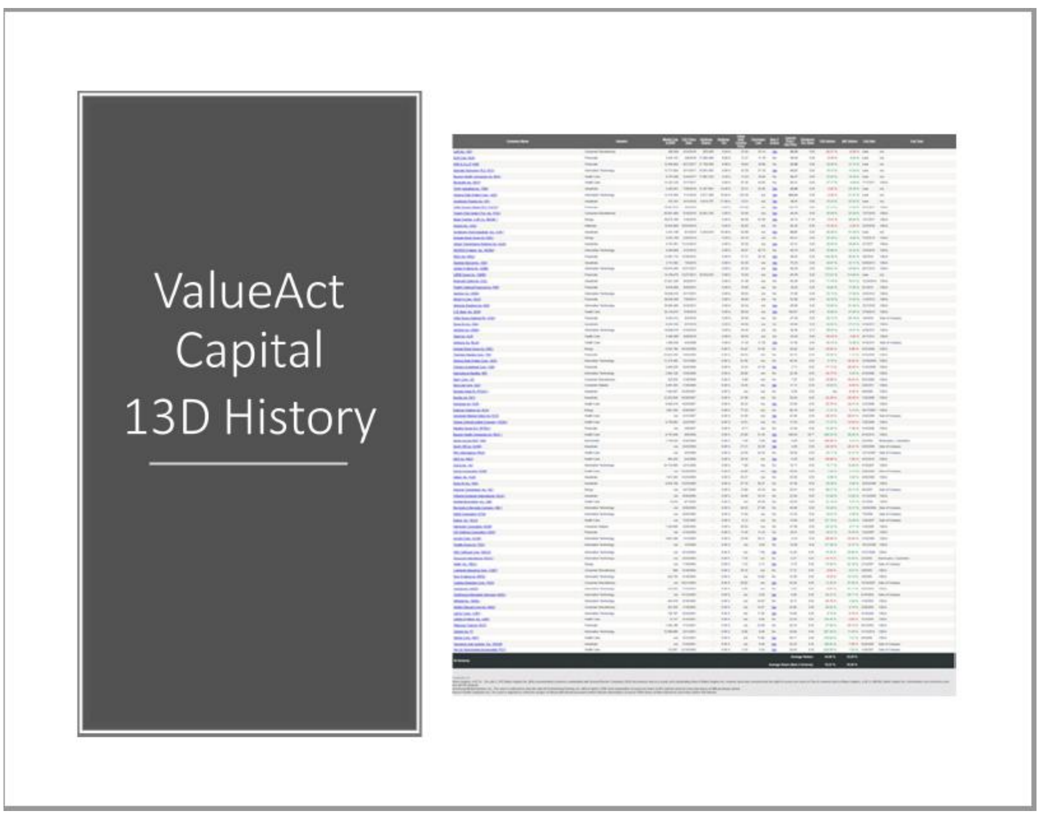
Source: Ken Squire (13D Monitor)



Source: Ken Squire (13D Monitor)

ValueAct Capital
Activist History

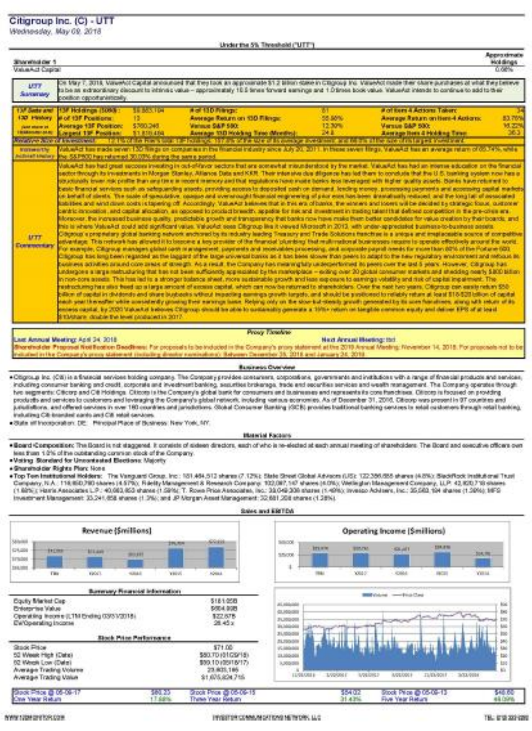
13D Situations

Company Name	Industry	Market Cap (x1000)	13D Filing Date	Holdings Shares	Holdings (%)	Filing Date Closing Price	Purchaser Cost	Item 4 Action	Current Price / Exit Price	Dividends Per Share	13D Return	S&P Return	Exit Date	Exit Type
SLM Corp (SLM)	Financials	4,401,531	4/6/2018	37,605,408	8.60 %	11.37	11.19	No	**10.14**	0.00	-9.40 %	4.55 %	**Live**	n/a
KKR & Co LP (KKR)	Financials	12,605,179	8/21/2017	47,750,000	9.99 %	18.64	18.86	No	**23.89**	0.00	28.69 %	12.14 %	**Live**	n/a
Willis Towers Watson PLC (WLTW)	Financials	19,927,970	4/5/2016	-	0.00 %	114.69	n/a	Yes	145.79	0.00	27.12 %	17.93 %	5/31/2017	13D/A
MSCI Inc (MSCI)	Financials	12,801,710	11/28/2012	-	0.00 %	27.31	28.16	Yes	68.82	0.00	144.39 %	40.92 %	3/8/2016	13D/A
CBRE Group Inc. (CBRE)	Financials	14,210,146	12/27/2011	19,916,923	5.90 %	15.30	n/a	Yes	**41.74**	0.00	172.81 %	114.68 %	**Live**	n/a
Fidelity National Financial Inc (FNF)	Financials	9,054,895	8/26/2011	-	0.00 %	15.95	n/a	No	18.63	0.00	16.80 %	17.06 %	8/1/2012	13D/A
Moody's Corp. (MCO)	Financials	28,636,540	7/20/2011	-	0.00 %	36.48	n/a	No	52.66	0.00	44.35 %	11.03 %	1/10/2013	13D/A
Willis Group Holdings Plc (WSH)	Financials	8,502,512	9/3/2010	-	0.00 %	30.48	n/a	No	47.28	0.00	55.12 %	80.19 %	1/6/2016	Sale of Company
Thomson Reuters Corp. (TRI)	Financials	25,622,290	10/6/2008	-	0.00 %	26.55	n/a	No	34.75	0.00	30.89 %	1.12 %	9/16/2009	13D/A
Chimera Investment Corp. (CIM)	Financials	3,465,229	4/24/2008	-	0.00 %	12.24	12.16	Yes	2.71	0.00	-77.71 %	-38.26 %	11/25/2008	13D/A
Reuters Group PLC (RTRSY)	Financials	n/a	2/9/2007	-	0.00 %	8.71	n/a	No	12.48	0.00	43.28 %	-7.46 %	3/18/2008	13D/A
USI Holdings Corporation (USIH)	Financials	n/a	2/10/2005	-	0.00 %	11.40	11.42	No	16.51	0.00	44.57 %	19.30 %	1/23/2007	13D/A
Redwood Trust Inc (RWT)	Financials	1,364,198	7/12/2001	-	0.00 %	n/a	22.99	No	29.33	0.00	27.58 %	-18.13 %	6/21/2002	13D/A

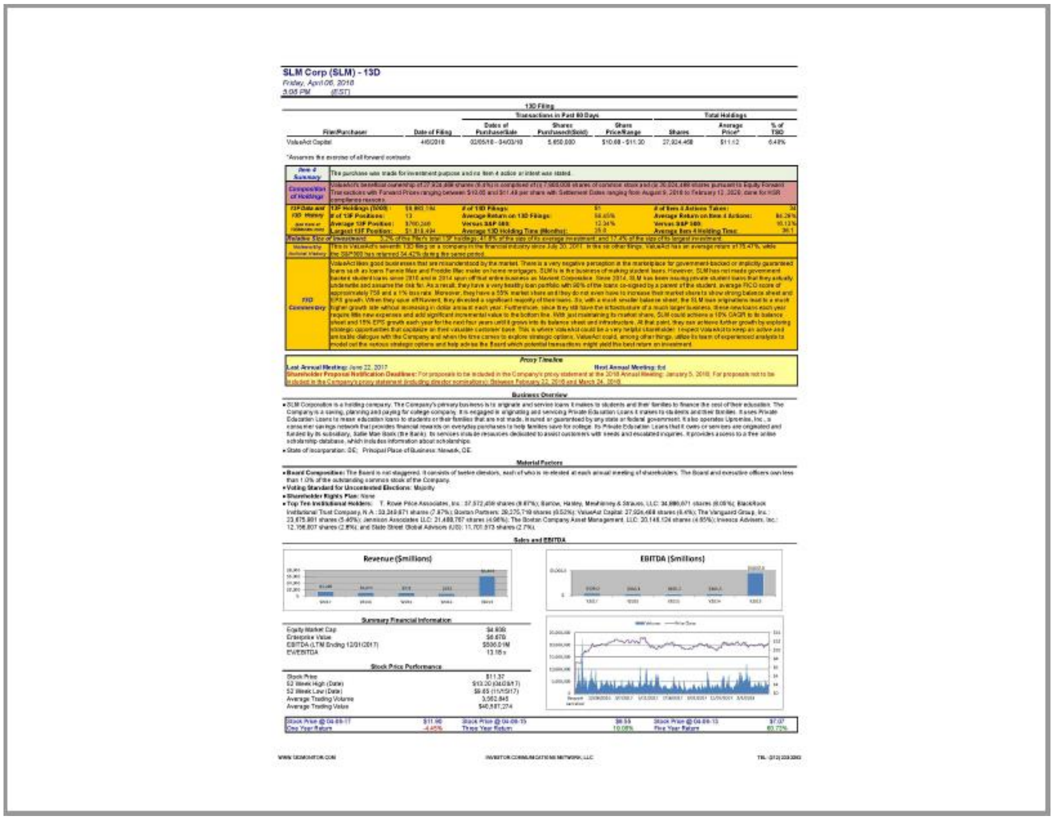
Under the Threshold - Activism where the activist owns 5% or less of the company's common stock, and therefore was not required to file a 13D.

Company Name	Industry	Market Cap (x1000)	Approximate Action Date	Holdings (%)	Announcement Date Price	Current Price / Exit Price	UTT Return	S&P Return	Exit Date	Exit Type
Citigroup Inc. (C)	Financials	$160,985,700	5/9/2018	1.00 %	71.00	**65.92**	-7.15 %	0.94 %	**Live**	n/a
KKR & Co LP (KKR)	Financials	$12,602,557	4/27/2017	4.90 %	18.73	18.14	-3.15 %	1.66 %	8/21/2017	Over 5%
Morgan Stanley (MS)	Financials	$80,173,090	8/15/2016	1.07 %	29.66	**45.95**	54.92 %	24.33 %	**Live**	n/a
American Express Co (AXP)	Financials	$88,595,490	8/7/2015	1.11 %	79.72	69.55	-12.76 %	-1.62 %	12/31/2015	13F

Source: Ken Squire (13D Monitor)



Source: Ken Squire (13D Monitor)



SLM Corp (SLM) - 13D
Friday, April 06, 2018
5:05 PM (EST)

		13D Filing					
		Transactions in Past 60 Days			Total Holdings		
Filer/Purchaser	Date of Filing	Dates of Purchase/Sale	Shares Purchased/(Sold)	Share Price/Range	Shares	Average Price*	% of TSO
ValueAct Capital	4/6/2018	02/05/18 - 04/03/18	5,650,000	$10.68 - $11.30	27,924,468	$11.12	6.48%

*Assumes the exercise of all forward contracts

Item 4 Summary	The purchase was made for investment purpose and no Item 4 action or intent was stated.

Source: Ken Squire (13D Monitor)

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Additional Information Available Upon Request

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD
3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

SECTOR RATING
O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.
M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING
V=A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: November 13, 2018

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