THE ACTIVIST REPORT

13D Monitor

Volume 3 Issue 8 August | 2013

An InDELLible Scar to Corporate Governance

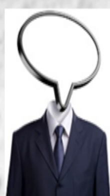
When discussing the current Dell deal with stockholders, there are three things that almost everyone agrees on: (i) the Dell/Silver Lake offer is too low, (ii) the Dell Board has abandoned any perception of good corporate governance and (iii) the deal is going to happen.

In February of 2013, Michael Dell and Silver Lake Partners (collectively "Dell/SL") entered in to a merger agreement with Dell to acquire the Company for $13.65 per share. The Agreement was approved by a Special Committee of independent directors (the "Special Committee") and a Special Meeting date of July 18 was set to have the transaction approved by shareholders. The transaction required two separate votes of shareholders to be approved: (i) a majority of all outstanding shares, including those held by Michael Dell

continued on page 5

In a time when many management teams under attack from shareholders are using any means necessary to keep their jobs, Health Management Associates removed the teeth from their "poison put" provision to level the playing field for Glenview Capital Partners and gave shareholders a true choice. On July 29, 2013, Health Management obtained the agreement of the requisite lenders under its Credit Agreement to waive any default which would otherwise arise if the persons nominated by Glenview in its consent solicitation statement are elected or appointed as directors of HMA, provided that such Glenview Nominees are approved by at least a majority of the current board of directors of HMA. After interviews with all of the Glenview Nominees had been conducted, the HMA Board of Directors approved the Glenview Nominees on August 1, 2013 solely for purposes of preventing a "Change of Control" under its applicable loan agreements, and for no other purpose. As a result of these developments, the potential consequences of the election of Glenview's Nominees under the indentures and Credit Agreement described in HMA's consent revocation statement have been eliminated. While the move we usually see by management is to use this provision to help entrench themselves despite shareholder opposition, it is nice to see a Board looking out for shareholders first, even if it might cost them their jobs.

QUOTE OF THE MONTH



"Activist Hedge Fund" has become an asset class in which institutional investors are making substantial investments. - Marty Lipton

Investor Communications Network
250 West 57th Street, Suite 915
New York, NY 10107
www.13DMonitor.com

10 Questions with Cliff Robbins

Mr. Robbins is the Founder and Chief Executive Officer of Blue Harbour Group, L.P. Prior to forming Blue Harbour, Mr. Robbins had been a Managing Member of General Atlantic Partners, LLC, a global private equity firm from 2000 through August 2004. Prior to that, Mr. Robbins had been a General Partner of Kohlberg Kravis Roberts & Co. ("KKR"), where he played a significant role in many of the firm's leveraged buyout transactions and financings, which aggregated in excess of $100 billion. Mr. Robbins has served on the Board of Directors of more than fifteen public and private companies. Mr. Robbins was able to make the time to sit down with us for this month's edition of 10 Questions.

13DM: While, to many, Blue Harbour falls on the spectrum of activist investors,

continued on page 2

IN THIS Issue

Item	Pg.
An InDELLible Scar to Corporate Governance	1
10 Questions - Cliff Robbins	1
Kudos - HMA	1
Behind the Scenes - BKR	6
Monthly Activist Activity	7
One to Watch	7
Activist Directory	8

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THE ACTIVIST REPORT

CLIFF ROBBINS (cont'd. from pg. 1)

you never start proxy fights, submit shareholder proposals or take board seats. Can you explain your strategy and philosophy on activism?

CR: You're right that there is a wide range of styles that fall under the activist strategy. Since our inception nine years ago, we've never waged a proxy contest, sued a company or publicly taken a position adverse to our management teams. We work as partners with the managements of our portfolio companies, and we are an exclusively collaborative active ownership investor. Our approach is to invest in undervalued companies where we have mutual respect with the management teams, and they are open to finding ways to unlock and create shareholder value and listen to new ideas. And we only invest if we believe we can achieve a 30%-50% return over a 2-3 year period.

Importantly, we focus on the $1-$5 billion market cap range, as we believe we can add the most value to companies of this size. Companies in this range often don't have the resources to fully analyze the broad spectrum of alpha-generating ideas and aren't as frequently approached by investment banks with ideas to unlock value.

Since I come from a private equity background, we tend to use a private equity "lens" when we invest. Before making any investment, we ask ourselves, "Would we buy this company in its entirety? Are there levers to unlock value?" We examine companies in their entirety as part of our diligence and investment strategy.

13DM: What is your level of discourse with management and boards? How much value can you add as a stockholder? Would you ever take a Board seat at a portfolio company?

CR: Throughout our engagement, we have very extensive dialogue with our management teams and boards, as we are typically the largest shareholder and develop a partnership relationship with of our portfolio companies. In this role, we have the opportunity to make recommendations to management teams in an effort to drive outsized shareholder returns.

We have found that we are able to provide constructive influence without board seats, and board representation generally is not a goal. I have served on many corporate boards in my private equity career, and the 4-to-5 year commitment that companies typically want from their directors is longer than Blue Harbour's typical 2-3 year investment period. In the instances when we believe a board needs to be strengthened, we have recommended qualified professionals, including former Blue Harbour portfolio company CEOs, to be considered.

It's possible that at some point we might take a board seat if the situation calls for it, but as the lead shareholder in our small and mid cap companies, we enjoy the relationship and access without the significant restrictions that come with board representation.

13DM: What do you do if a Company severely resists your overtures? Do you walk away or are there ways to apply more pressure without resorting to a proxy fight? Would you ever commence a proxy fight?

CR: While we haven't seen companies severely resist our engagement, of course the relationship building and embracing of our ideas to unlock and to create shareholder value take time. If a company isn't initially receptive, we're willing to put in the time to try to build a sense of partnership and, ultimately, support for our ideas. Some of the best investment ideas we have made today are with companies that we began talking to a few years ago.

We don't shy away from a spirited debate in private, but I seriously doubt we would ever get into a proxy fight, and we take pains to avoid investing in companies where we aren't on the same page with the management and Board in terms of value creation. A real virtue of our collaborative strategy is that it naturally fits my prior experience in private equity, where there's a premium on sizing up management teams of companies you're considering buying as well as the ones you already own. So at Blue Harbour, one critical goal of our due diligence conversations with management is to form a judgment on whether management is hungry to win and open to change. If we detect that management is closed-minded and not looking for new ideas or ways to unlock value, we typically don't spend further time there. On the other hand, if they're interested in hearing and engaging with what we have to say, we view it as a positive sign. I'd also add that one of the great advantages of having pursued our strategy for nearly nine years is that we have a roster of 40 former Blue Harbour CEOs on whom

continued on page 3

> **"So, while our active value plans for a company quite often involve value creating ideas that have nothing to do with the sale of the company, it has frequently developed that our companies are sought after by private equity or strategic buyers."**

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CLIFF ROBBINS (cont'd. from pg. 2)

we can call on as representatives of our strategy and our investments. These references have served us well, as managements and boards are less wary and, frankly, intrigued to meet with Blue Harbour given our record of having successfully worked in partnership with so many other companies historically.

13DM: You have a private equity background. I have always felt that private equity and activists have had a love/hate relationship. The two groups are symbiotic when activists come into a company and urge the Board to sell the Company or a subsidiary but they are antagonistic when a private equity fund attempts to acquire a public company and an activist fights them for a higher price. What are your thoughts on this relationship and how do you think activists are viewed by the private equity world?

CR: Our take on the association between private equity and activists is somewhat different. We at Blue Harbour are very much like a private equity firm in terms of the relationships we forge with managements and the types of value-enhancing actions we ask management teams to act on. The difference is that unlike PE firms, we avoid paying a 30-50% control premium and we enjoy significant liquidity as we seek to drive value creation as a lead minority investor instead of purchasing companies in their entirety.

On several occasions over the years, our management teams have considered going private transactions, and we have been a good sounding board for those strategies. Our overall attitude is quite simply this: it's a matter of price. Sometimes, it's our view that a company can create more value over time for shareholders by remaining public; and in other cases, the best deal for stockholders is to take a significant premium from a private equity or a strategic buyer that we deem is the best risk-adjusted return opportunity.

13DM: A significant number of those companies in which you've filed a 13D have been acquired in a relatively short time after your 13D engagement, usually for very nice premiums. Is this a coincidence or does it have to do with applying a private equity model to public investing?

> **"Given the paradigm shift of corporate governance and the increasing voice that institutional shareholders have demanded from companies and managements, I see the tailwinds for activism only increasing over the next five to ten years."**

CR: It's not a coincidence. We are attracted to companies that are led by excellent management teams, that are trading at a significant discount to intrinsic value, that generate high levels of free cash flow, and that have multiple levers to create substantial shareholder value. These are the same attributes that both private equity and strategic buyers seek. So, while our active value plans for a company quite often involve value creating ideas that have nothing to do with the sale of the company, it has frequently developed that our companies are sought after by private equity or strategic buyers.

13DM: Since the beginning of 2012 the S&P500 is up 34%, we have extremely low interest rates, there is $1.45 trillion of cash on corporate balance sheets and another $1 trillion that private equity funds are sitting on. Yet, the M&A markets have been anemic. What do you attribute this to and what has to happen for M&A to return?

CR: The seeds clearly have been planted for a significant increase in M&A activity, for all of the reasons you mentioned, as well as the ripe financing market and the accretive nature of most deals. I would also add that in the recession years following the 2008-2009 crisis, companies got very lean because productivity was their main available tool for driving earnings growth. Now many companies are facing a paradox: they have little left to cut so they need to grow revenues in order to keep driving earnings growth, but they also underinvested during the recession making organic growth difficult. One answer, particularly given the availability of capital, is to buy growth through M&A.

Companies in the small and mid cap market segment, where Blue Harbour focuses, have been early beneficiaries of these dynamics, in part because their size makes them manageable both to acquire and to integrate. In our portfolio over the past year alone, our portfolio company Warnaco was acquired by PVH, Arbitron by Nielsen, Power-One by ABB, and, most recently, Harris Teeter by Kroger. Of course, as I mentioned, by selecting our investments through a private equity lens and by focusing on high quality, undervalued companies, we see somewhat of a disproportionate amount of M&A activity. And we like to find great acquirers just as much as potential targets: it's our job to find those companies that are willing to deploy cash to increase shareholder value, and if the best strategy is acquisitions by a great management team, we will be very supportive.

I think the dynamics we're seeing contributing to rising M&A in the small and midcap market segment

continued on page 4

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CLIFF ROBBINS (cont'd. from pg. 3)

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will permeate more broadly across the market. The missing ingredient has been confidence on the part of the acquirers' management and boards. When you think about the litany of blows to confidence and obstacles to restoring confidence between 2008 and 2012, it's staggering, but the good news is that those issues – credit crisis, housing crisis, Euro crisis, elections, and fiscal cliff - are steadily shrinking in the rear view mirror, so not only is the economy healing, but confidence is healing and returning too. We expect a significant uptick in M&A as a result.

13DM: You have been investing professionally for over 25 years, the last nine at Blue Harbour. How has the role of a public investor changed over that time? How have boards changed in their receptiveness to work with shareholders?

CR: I definitely agree that there has been a huge change in the role of public investors over my career. First, there has been a huge change in Board receptivity over the past decade and most markedly over the past five years. Directors have realized that the root cause of the financial crisis itself was poor corporate oversight in the financial sector. Following the financial crisis, companies became more aware of corporate governance and the importance of listening to their shareholders; and this has been a real turning point for activists and investors like Blue Harbour. There's been a real paradigm shift, and I think it's here to stay. And, importantly, large public pension plans have also been very vocal on the issue of shareholder engagement, changing broker voting and proxy access rules, and this has been critical for the success for active investors like Blue Harbour because we need management teams and boards to be aligned with shareholder interests.

13DM: If you had to change one SEC rule regarding corporate governance, what would it be?

CR: I think one corporate governance trend I would like to see more of is the separation of the Chairman and the CEO. As you know, separation of these roles allows for increased independence of the board and allows for better checks and balances on management's representation of shareholder interests.

Of course, we have portfolio companies in which the Chairman and CEO are the same person, but we do our work ahead of time to find those management teams and boards that think with shareholders interests in mind, as they are willing to collaborate to unlock strategic value in their respective companies. Consequently, I believe the separation of Chairman and CEO is not necessarily a blanket fix-all for corporate governance issues, but it does lend itself to improved accountability. Management teams that listen to shareholders, that are willing to work with us, and who are committed to generating alpha already have the interests of their stakeholders in mind; but I think by changing this rule, there may be some improved oversight of management teams and accountability.

13DM: Where they are trading right now, what is your favorite investment in your portfolio and why?

CR: It's hard to pick a favorite, but as of now, I like Brocade (BRCD). It's a new Core position in our portfolio and is a $2.6 billion market cap information technology company that provides storage and communications networking hardware to enterprise, service provider and government customers. The Company's fibre channel switch business has approximately 70% market share in a duopoly market. We like this industry structure and Brocade's relative competitive positioning within what is a durable business with a massive installed customer base.

In recent years, the market has been skeptical of Brocade given secular concerns around the storage business, as well as some self-induced execution challenges. The Company's prior leadership also allowed the cost structure to inflate, which has dampened the overall margin profile.

We believe the fibre channel storage business will remain resilient and continue to generate robust cash flow for the foreseeable future. We view the recent soft results in storage as more cyclical in nature, owing to the weak macro economy rather than due to a secular decline in storage networking. We also believe that after a few years of admitted mismanagement, Brocade will benefit from its new CEO, Lloyd Carney, who brings a wealth of communications networking experience and has made recent changes to the team and to the sales distribution model which we expect to drive improved results in this business going forward.

In conjunction with these operating changes, Carney and the Brocade Board are evaluating the Company's capital allocation strategy. As a 5% owner of the Company's shares, we have taken a very active role within these discussions.

13DM: Do you see the level of shareholder activism increasing or decreasing over the next five to ten years?

CR: Given the paradigm shift of corporate governance and the increasing voice that institutional shareholders have demanded from companies and managements, I see the tailwinds for activism only increasing over the next five to ten years. Activism, in and of itself, has become increasingly popular as a strategy. Shareholders are demanding more from companies' management teams and boards, and I think this is a positive corporate governance trend which positions activists to generate significant alpha to investors.

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DELL (cont'd. from pg. 1)

and his affiliates (the "Delaware Law Requirement") and (ii) a majority of the outstanding shares not held by Michael Dell or his affiliates (the "Unaffiliated Vote"). The second vote was not required by law, but something the Special Committee insisted on as an extra safety measure for shareholders, given that the transaction involved the Company's Founder/Chairman/CEO. This was so important to the Special Committee that it was the only provision that was singled out as not being waivable. Since both of these votes require the affirmative vote of outstanding shares, as opposed to votes cast, not voting is the equivalent of a "no vote."

Between the date of the Dell Merger Agreement and the date of the Special Meeting, Carl Icahn acquired an 8.68% position and teamed up with Southeastern Asset Management (4.0%) to oppose the merger and make a competing offer – a recapitalization whereby Icahn/Southeastern would make a tender offer for 1.1 million shares at $14 per share plus a warrant to acquire one share for every four tendered with a $20 strike price and a seven year term. The Board did not characterize the Icahn/Southeastern Offer as a Superior Proposal under the Merger Agreement and continued on with the approval process for the Dell/SL transaction.

On July 18 the Board adjourned the Special Meeting until July 24 for one reason and for one reason only - Michael Dell and Silver Lake did not have enough votes to approve the transaction. This is not unprecedented and the Board can justify this by saying they are working in the interest of the stockholders to get a better offer that will be approved. This rationale becomes a little more problematic when you have the Founder/Chairman/CEO as the potential acquirer, and the second largest shareholder with a competing offer that is being ignored. The stumbling block seemed to be the Unaffiliated Vote, as there were approximately 20% of the shares that did not vote.

On July 24, still without enough votes, Dell/SL boosted their offer by 10 cents per share (or 0.7%) and made it contingent on the Board changing the Unaffiliated Vote requirement from a majority of unaffiliated outstanding shares to shares actually voted. The Board did not see a 0.7% bump as enough consideration to amend the most significant shareholder protection of the Merger Agreement and asked for a $14.00 price if they were to consider any such amendment. Also the Board rescheduled the Special Meeting for August 2. On August 2, Dell/SL added a 13 cent dividend to their offer and the Board agreed to change the voting standard and adjourned the meeting to September 12 with a new record date, which will also help Michael Dell. While a 0.7% bump was not sufficient, the Board apparently was ok with a 1.7% bump, despite the fact that the S&P500 was up over 13% since the Merger Agreement was signed and the 13 cent dividend can be paid with the approximate 20 cents per share Dell would normally generate during the two month period that the closing of the transaction is now being delayed. On the same day the Board announced that the Annual Meeting, which is normally held in July, will be held on October 17.

While it is helpful to Dell/SL that the Board adjourned the meeting a third time, changed the record date and scheduled the Annual Meeting after the Special Meeting, that is not why Dell/SL raised their bid. What they really needed was the Board to amend the Unaffiliated Vote to require a majority of only unaffiliated votes cast, and not outstanding shares. That was the only thing preventing this deal from happening from the very beginning.

With 20% of shareholders not voting and Icahn and Southeastern Asset Management opposing the deal, Dell/SL was unable to get 42%. Dell/SL and the Board blamed this on the 20% of shares not voting, but when drafting the merger agreement and this particular voting requirement, the Company knew that approximately 25% of Dell shareholders do not cast votes at annual meetings, so this should not have surprised them. The real reason they could not get the vote and what they did not expect was the opposition of Carl Icahn and Southeastern Asset Management and their 13% of shares. Without their opposition and alternative proposal, Dell would have likely been able to get the unaffiliated vote even with 20% of shares not voting.

So, this deal was dead in its tracks unless Carl Icahn went away or a change was made to the "un-waivable" voting standard. And it is virtually impossible to get Carl Icahn to walk away. So, that left them with only one option and the Board agreed to amend the Unaffiliated Vote requirement to require a majority of only unaffiliated votes cast, and not outstanding shares. While this may seem like a reasonable and logical change, it effectively neutered the requirement and rendered the whole Unaffiliated Vote meaningless. Since Michael Dell owns 16% of the Company's common stock, he would already need approximately 34% of other shareholders to approve the transaction to satisfy the Delaware Law Requirement. The Unaffiliated Vote required 42% of other shareholders. So, as intended, the Unaffiliated Vote requirement is a higher standard as an extra safety measure for shareholders. With the amended threshold of only votes cast, assuming that 20% of shareholders were not voting, Michael Dell would no longer need 42% of unaffiliated shareholders to satisfy this voting requirement, but 32%. So, what was intended to be a "higher voting standard"

continued on page 6

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DELL (cont'd. from pg. 5)

now requires less unaffiliated shareholders than the Delaware Law Requirement, rendering the Unaffiliated Vote completely moot and effectively waiving it. The argument can be made that there is a chance, however slim, that only 10% of shareholders do not cast votes, in which case the Unaffiliated Vote requires 37%, slightly more than the 34% needed for the Delaware Law Requirement. However, If only 10% of shareholders do not vote, the entire rationale for amending the voting requirement (that a large number of shareholders were not casting votes) goes out the window.

So, with the Board finally abandoning even the pretext of good corporate governance and cowering to its leader, Michael Dell, for a 1.7% price bump, this deal is all but a certainty. The three things that could prevent it are all very unlikely. First, Icahn/Southeastern could significantly bump their price or restructure their offer – highly unlikely that they can do this to such a degree that the Special Committee could not find a reason to continue to back Michael Dell. Second, Carl Icahn's lawsuit that he commenced to estop some of these questionable corporate governance actions could prevail – however, the Delaware courts give significant latitude to corporate boards exercising their business judgment, particularly when the decision is made by a committee of directors who are perceived to be independent. Third, there could be a backlash from the large institutional investors to block the transaction on corporate governance principals – this is also very unlikely because the portfolio managers usually carry more weight than the corporate governance executives and in the end it is the price that matters to these investors more than the process.

So this deal will ultimately happen and when we look back on this we will see a Board who focused solely on the offer made by its Founder/Chairman/CEO, repeatedly adjourned meetings until the Founder could garner enough votes and when that failed to happen, changed the Unaffiliated Vote requirement to render the largest shareholder protection moot. All of this while the world's most prolific activist investor was strenuously fighting the transaction. The Dell deal will ultimately demonstrate the inordinate amount of power that a corporate Board has versus the shareholders who elect them, show activists that there is very little they can do without the support of shareholders and remind shareholders of how powerless they are to determine their own fates, particularly when you have a Board who is willing to change the rules if they don't like how it is going.

BEHIND THE SCENES
Crescendo Partners and Michael Baker (BKR)

In the January 2013 edition of the Activist Report we discussed Michael Baker Corp. and the offer made by 13D filer DC Capital to acquire the Company for $24.25 per share. In that column we said: "DC Capital is not an activist investor, but there is an experienced activist who owns well below the 5% 13D threshold who is urging the Board to sell the Company, but in a process that maximizes shareholder value." We reported that Crescendo Partners had a sub-5% position and threatened to run a proxy fight if the Company did not take the necessary steps in furtherance of consummating a value maximizing transaction. Crescendo thought that the Company could be sold for more than $30 per share. On July 29, it was announced that the company entered into an agreement to sell itself to DC Capital for $40.50 per share. What has not been made public is that Crescendo Partners had followed through on its threat and nominated three directors earlier this year to put pressure on the Board to sell the Company.

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New Filings for July

Company Name	Investor	Mkt. Cap.	Filing Date	%	Cost	Item 4 Action
Tecumseh Products (TECUA)	Todd W. Herrick	$146.35M	7/2/13	33.10%	n/a	consolidate classes of stock
Penford Corp. (PENX)	SEACOR Hldgs.	$167.15M	7/3/13	9.55%	$5.89	board representation
Progressive Waste Sol. (BIN)	Blue Harbour	$2.55B	7/5/13	5.60%	$20.44	n/a
Emulex Corp. (ELX)	Starboard	$694.16M	7/8/13	6.90%	$6.36	n/a
Chatham Lodging Trust (CLDT)	HG Vora	$413.04M	7/12/13	9.80%	n/a	potential privatization
AeroVironment (AVAV)	Engaged	$466.980M	7/17/13	5.10%	$19.87	board representation
Sotheby's (BID)	Marcato	$2.96B	7/30/13	6.61%	n/a	enhance shareholder value
Air Products & Chemicals (APD)	Pershing Square	$22.95B	7/31/13	9.80%	$98.91	n/a

One to Watch

Company

Air Products & Chemicals Inc. (APD)
Market Cap.: $22.9B ($109.5/share)
Enterprise Value: $28.7B
Cash: $418.8M
Debt: $6.1B
EBITDA: $2.4B

Investor

Pershing Square, LLC
13F Holdings: $10.1B
# of 13F Positions: 9
Largest Position: $3.2B
Avg. Return on 13Ds: 205.8%
Versus S&P500 avg: 10.12%

Investment

Date of 13D: 7/31/13
Beneficial Ownership: 9.8%
Average Cost: $98.9
Amount Invested: $2.0B
Highest price paid: $106.4
# of larger shareholders: 0

Air Products is a leading company in an oligopoly where four companies make up 75% of the market. They provide essential products and services, industrial gasses, to industries like steel mills, refineries, food producers and chip manufacturers, where their product is a small part of the cost of production but can have a drastic impact. They enter into 15 – 20 year "take or pay" contracts with a large portion of their customers and have a 95% renewal rate. They also have a merchant business that sells excess gas to companies like hospitals and frackers. The gas business is growing at 1.5 – 2 times the rate of industrial production and increased environmental regulation is a secular trend that adds to that growth. From an activist perspective, this looks a lot like Canadian Pacific. The CEO has been in office since October 1, 2007 and since then the Company's stock has been down 4.7% (through the date that Pershing Square started acquiring its position). During that time, its closest direct competitor, Praxair, is up 36.0%. Like the Canadian Pacific situation, APD is lagging behind Praxair (think Canadian National) by 600 – 700 basis points in terms of operating margin. At CP, Pershing Square won a hotly contested proxy fight, brought in new management and are up 121.1% on their investment in under two years. If a change in management is what Pershing Square is looking for here, like CP, they probably already have people in mind. Unlike CP, the CEO here would not need specialized experience, just experience in running companies efficiently with capital discipline (Praxair's CEO is a former GE executive). The other opportunity here that Pershing Square alluded to in a letter to investors is the opportunity to deploy growth capital in its core business at attractive rates of return. The demand for industrial gasses is growing globally in countries like India, China and Brazil and there is an opportunity to build plants in these regions. Moreover, because the cost to transport gas is so expensive, these plants tend to have mini-monopolies in their region.

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Activist/Activist Defense Directory

Investment Banks

	Contact	Phone Number	E-mail
Bank of America/Merrill Lynch	Kevin J. Daniels	(646) 855-4274	kevin.j.daniels@baml.com
Barclays (Solely Corporate Counsel)	Daniel Kerstein	(212) 526-0406	daniel.kerstein@barclays.com
CamberView Partners, LLC	Abe M. Friedman	(510) 590-1182	abe.friedman@camberview.com
Citibank	Scott Davis	(212) 816-4571	scott.g.davis@citi.com
Credit Suisse	Chris Young	(212) 538-2335	chris.young@credit-suisse.com
Evercore Partners	Lyle Ayes	(212) 849-3699	lyle.ayes@evercore.com
Goldman Sachs (Solely Corporate Counsel)	Bill Anderson	(212) 902-0043	william.anderson@gs.com
Greenhill & Co., LLC	Birger K. Berendes	(212) 389-1564	bberendes@greenhill.com
Houlihan Lokey	Gregg Feinstein	(212) 497-7885	gfeinstein@hl.com
J.P. Morgan	David A. Hunker	(212) 622-3724	david.a.hunker@jpmorgan.com
Morgan Stanley	Mahmoud Mamdani	(212) 761-7472	mahmoud.mamdani@ morganstanley.com
Moelis & Company	Craig Wadler	(310) 443-2330	craig.wadler@moelis.com
Perella Weinberg	Riccardo Benedetti	(212) 287-3178	rbenedetti@pwpartners.com
Societe Generale (Derivatives)	Joseph White	(212) 278-5126	joseph.white@sgcib.com
Wells Fargo	Stavros Tsibiridis	(212) 214-5273	stavros.tsibiridis@wellsfargo.com

Law Firms

	Contact	Phone Number	E-mail
Cravath, Swaine & Moore (for	Robert I. Townsend III	(212) 474-1964	rtownsend@cravath.com
Activist Defense only)	Faiza J. Saeed	(212) 474-1454	fsaeed@cravath.com
Goodwin Procter	Joseph L. Johnson	(617) 570-1633	jjohnson@goodwinprocter.com
Latham & Watkins	Paul Tosetti	(213) 891-8770	paul.tosetti@lw.com
Olshan Frome Wolosky	Steve Wolosky	(212) 451-2333	swolosky@olshanlaw.com
Sullivan & Cromwell	James C. Morphy	(212) 558-4000	morphyj@sullcrom.com
Schulte Roth & Zabel	Marc Weingarten	(212) 756-2280	marc.weingarten@srz.com
	David Rosewater	(212) 756-2208	david.rosewater@srz.com
Wachtell Lipton (Primarily Corporate Counsel)	David A. Katz	(212) 403-1309	dakatz@wlrk.com

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Activist/Activist Defense Directory

Proxy Solicitors

	Contact	Phone Number	E-mail
Innisfree	Art Crozier	(212) 750-5837	acrozier@innisfreema.com
Mackenzie Partners	Daniel H. Burch	(212) 929-5748	dburch@mackenziepartners.com
Morrow & Co.	John Ferguson	(203) 658-9400	j.ferguson@morrowco.com
Okapi Partners	Bruce H. Goldfarb	(212) 297-0722	bhgoldfarb@okapipartners.com

Public Relations

	Contact	Phone Number	E-mail
ICR, Inc.	Don Duffy	(203) 682-8215	dduffy@icrinc.com
Joele Frank	Matthew Sherman	(212) 355-4449	msherman@joelefrank.com
Sard Verbinnen & Co.	George Sard	(212) 687-8080	gsard@sardverb.com
	Paul Verbinnen	(212) 687-8080	pv@sardverb.com

Executive Recruiters
(for dissident nominees)

	Contact	Phone Number	E-mail
Seiden Krieger Associates, Inc.	Steven Seiden	(212) 688-8383	steven@seidenkrieger.com

Research Services

	Contact	Phone Number	E-mail
13D Monitor	Ken Squire	(212) 223-2282	ksquire@icomm-net.com

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