Activist Insight
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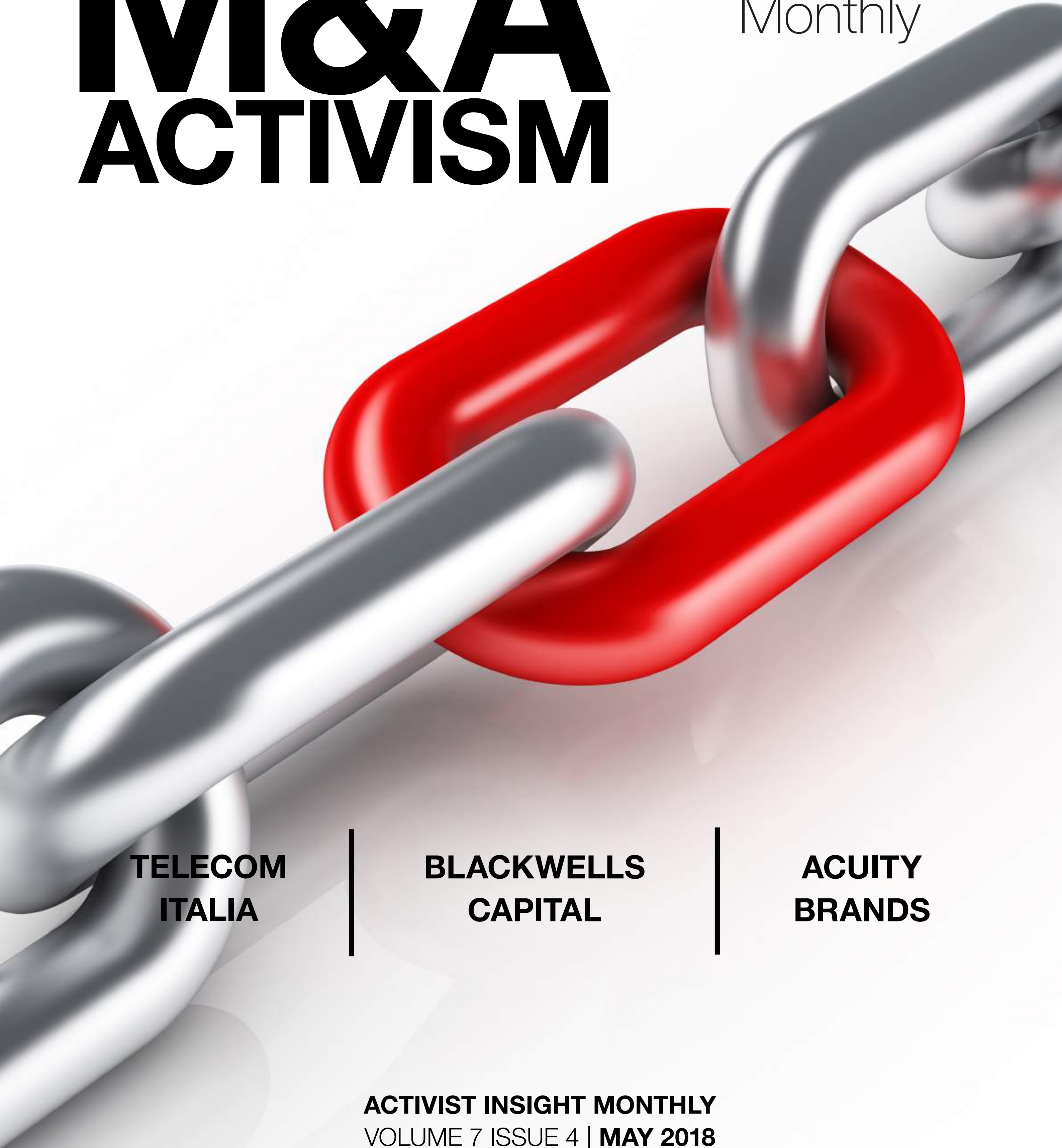

TELECOM ITALIA | BLACKWELLS CAPITAL | ACUITY BRANDS

ACTIVIST INSIGHT MONTHLY
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The Italian job

After a tumultuous year, marked by clashes with the Italian government and Silvio Berlusconi, French group Vivendi is seeing its dominance at Telecom Italia challenged by an equally versed adversary, Paul Singer's Elliott Management.

Telecom Italia Industries

Sector - Technology

Market cap - EUR 12.4B (large cap)

Exchange - Milan

Ticker: TIT.MI

HQ - Rome, Italy

The appearance of Elliott Management on shareholder registers is typically met with trepidation, suspicion or optimism, depending on who you ask. When Elliott disclosed a stake in Telecom Italia (TIM), it was not only shareholders who projected a sense of hope, but also stakeholders, including the Italian government.

Vivendi has signaled from the beginning that it would not give up control easily, unsurprising given that it took two years and a stroke of luck for the French conglomerate to consolidate its grip on TIM. Its gambit started in 2015, when Vincent Bolloré took a 15% stake and made known his intention of creating a Southern European media empire capable of competing with Netflix and Amazon. Vivendi gained four board seats at the end of 2015, increased its stake to 24%, and achieved control last year in a proxy contest with Assogestioni, a minority shareholder lobby group, that was won by a tiny margin of just 0.4%.

> "Whoever wins on May 4 only wins the first battle but not the war."

Misaligned interests

Under the effective control of Vivendi, TIM irritated Italian authorities and antagonized shareholders with an underperforming stock and related-party transactions. The share price – down by one-third between Vivendi's appointment of directors in December 2015 and the start of Elliott's foray in March – reflected disenchantment. On the other hand, fundamentals have improved during Vivendi's reign, with the company finally halting years of falling revenues.

While TIM's financial standing improved in those years, as Elliott itself has admitted, Vivendi managed to make many enemies in Italy, scaring away investors. Elliott notes in a presentation that the stock price dropped despite solid results, attributing the poor performance to the "Vivendi discount." Indeed, in a March 8 report Goldman Sachs analysts noted that TIM shares traded at "the widest discount" to the sector in years but could double with greater "investor confidence in corporate governance."

Liberation

As frustration and the valuation gap grew, Elliott saw an opening. The activist says it came to "liberate" TIM by replacing Vivendi-appointed directors with a group of top Italian executives and academics, whom it maintains are independent.

Though not a first, this campaign is perhaps the most complex operation launched in the country so far. At the turn of this century Elliott had brief incursions into TIM shares, crusading for the end of the non-voting saving stock and opposing a merger with Olivetti in 2003. About two years ago, the activist gained additional experience in the intricate Italian landscape when it launched an action to squeeze a higher price from Hitachi's buyout of Ansaldo

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STS, a campaign loaded with court fights and complex strategies. A resolution is still out of sight, despite rumors in March that a deal was close.

Now, Bolloré’s way of doing business is questioned not only in Italy but also at home in France, where he was arrested a week before the contest over alleged corruption in Africa (on charges he and his company deny). Elliott capitalized on the development by sending a letter to shareholders describing the arrest as “the latest instance of a troubling track record of conflict, self-interest, and even graver issues of potential criminality by those who would purport to ask for our trust in guiding TIM.”

Yet the campaign also entails a balancing act. While Elliott is keen on ending Bolloré’s influence, it is supportive of Vivendi-backed CEO Amos Genish, who indicated he would leave if the U.S. hedge fund wins the proxy fight. Vivendi’s large stake and TIM’s typically low turnout will play into its hands, while the possible departure of well-regarded Genish may prompt some institutional shareholders to back Vivendi to ensure continuity.

“Amos Genish has a strong track record as manager in the telecom sector,” Marco Taricco, founding partner of Bluebell Partners, which is one of Elliott’s advisers on the TIM campaign, told *Activist Insight Monthly*. “We don’t see the reason to change yet another CEO. TIM has changed 12 CEOs since its privatization [in 1997], which means an average tenure of less than two years.”

An unlikely ally

While a typical activist battle involves two opposing parties, the strategic significance of TIM’s fixed network means there is also a third player - the government, which has its own interest and is not sitting on the sidelines. The Italian state bought 4.2% of the stock through its investment bank Cassa Depositi e Prestiti (CDP) and sent a subtle yet clear message that it preferred Elliott’s nominees.

Indeed, Italy was forced to exercise its “golden power” for the first time in its history to protect the former phone monopoly when a competition regulator ordered Vivendi to decrease its ownership in either TIM or Silvio Berlusconi’s Mediaset - in which the French company acquired a 29% stake - to prevent Vivendi from wielding too much influence in the country’s media sector.

“Elliott typically portrays itself as a defender of minority shareholders, but in the case of TIM it gained support from an unlikely ally, the Italian government,” a lawyer familiar with the Italian corporate landscape, who asked not to be identified, told *Activist Insight Monthly*.

The government wants to ensure strategic assets, such as the Sparkle subsea cable unit, do not fall into foreign hands and that the fixed-line network receives badly-needed investments. Vivendi has agreed to spin off the sensitive units and signaled it was keen on cooperating, but Elliott argues the relationship with the government has already been “eroded.”

Close call

Shortly after Elliott nominated six candidates, eight Vivendi nominees resigned from the board and the company called a new meeting for May 4, where each side will advance a slate of 10 directors. Initially, Vivendi’s move was seen as an attempt to scout for new directors that would be able to better compete with Elliott’s slate of heavyweights. But Vivendi added only three new directors, including a Vivendi employee, and said Arnaud de Puyfontaine’s role will be downsized from executive to non-executive chairman.

Like the food and shopping, proxy rules are more exciting in Italy.

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Vivendi’s new list of directors raised more questions than it answered about its strategy in the proxy contest in view of the fact that its involvement was regarded with skepticism from the beginning. Proxy advisers Glass Lewis and Institutional Shareholder Services recommended against the election of Vivendi’s nominees in both 2015 and 2017. This year, Glass Lewis wrote that Vivendi’s control over TIM was “unambiguous” and “disconcerting,” and accruing at the expense of unaffiliated investors.

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Path forward

Because both Elliott and Bolloré are known for their persistence, the conflict may result in protracted animosity. Even if Elliott wins the proxy solicitation, it is hard to believe Vivendi will simply walk away. It would still have a giant stake and five members on the 15-member board, so it could frustrate the decision-making process until the next meeting when it can try to regain control. “Whoever wins on May 4 only wins the first battle but not the war,” Taricco noted.

Another possibility is a litigious quagmire, given the unpredictable Italian legal landscape. But the most optimistic scenario would see all parties try to work through their differences to benefit the company as a whole. Elliott’s support for Vivendi-backed CEO Amos Genish, albeit with an accelerated fixed-network spinoff, makes that less far-fetched than it seems. Playing second fiddle may not be acceptable for Bolloré, who is accustomed to calling the shots, but his choices may be limited.

Telecom Italia’s share price performance