LIPPER HEDGEWORLD

The Activist Family Tree

By Jacob Bunge, Financial Correspondent
Friday, September 21, 2007

NEW YORK (HedgeWorld.com)—"Knowing is half the battle" was the familiar refrain of the public service announcements at the end of every episode of the 1980s' cartoon series "G.I. Joe." Twenty years later, the words still ring true on a different battlefield, where the heroic Joes and evil Cobra Command are replaced by public companies and activist hedge funds—though which side is fighting for the forces of good probably depends on where you're sitting.

Following a volatile summer in the credit markets, activist funds may be in a stronger position than ever before to effect change in corporate policy, according to Damien Park, president and chief executive of Hedge Fund Solutions LLC, a consultancy serving both activist managers and the companies they target. For these companies, learning about activist funds—the different approaches they take and motivations they have—can be the best preparation for the day an activist files a Schedule 13D with the company's name on it. Schedule 13D is used to report to the Securities and Exchange Commission instances in which an investor acquires 5% or more of a class of securities; say, for instance, an activist hedge fund buying a significant number of shares of a particular company to pursue an agenda.

In a paper titled "Understanding and Managing Activist Hedge Funds," Mr. Park reported that since the beginning of the year, more than 200 activist funds have agitated for change at 333 U.S. companies, across a wide range of industries and market capitalizations. In about 45% of those cases activists pushed for transaction-related events, such as exploring strategic alternatives, a share repurchase or special dividend. In 40% of the cases, activist funds wanted changes in corporate governance, usually representation on the company's board of directors. Other requests included changes in management and executive compensation.

The busiest activist, according to Mr. Park's research, was Third Point LLC, which was involved in actions at 15 separate companies. Chapman Capital LLC, Ramius Capital Partners LLC and Shamrock Capital Advisors Inc. tied for second, involved with 10 companies each.

Their results, Mr. Park wrote, were mixed: "Some of these situations have generated improvements in shareholder value, while others were absolutely devastating to the company, its employees, and its stock price." In response, many companies are now seeking advice from lawyers, bankers and management consultants like HFS about whether their companies present attractive targets for activist funds, and what to do if one comes calling.

Knowing what sort of activist is at the door is the first step. Mr. Park identified four main types of activist investors in the paper, expanding on a concept he mentioned at the Managed Funds Association's Forum 2007 in Chicago this past June **Previous HedgeWorld Story**.

The "constructive activist" prefers to work behind the scenes with boards and management to unlock what the activist sees as hidden value, while putting together plans for the company's long-term growth. This can include the common activist goals of spinning off a division of the company or a share buyback, but this sort of investor won't make the front page of the *Wall Street Journal* or be highlighted in the gossip section of the *New York Post,* Mr. Park wrote.

The constructive activist's approach often works best with small-cap and midcap companies, Mr. Park said in an interview, because these organizations may not have the resources to carry out sophisticated financial analysis. A constructive activist can come in and analyze the effects of a share buyback or dividend distribution and how it will relate to the company's balance sheet, explain this to management, and work out an agreement that is acceptable to both parties.

Another class of activist identified by Mr. Park is the "operational activist," which often will introduce companies to outside managers with business- or industry-specific experience, in an effort to improve the company's operations. These tend to be more long-term investors and generally are not interested in one-time gains via share buybacks and so on. However, Mr. Park noted, if management won't listen, or if the investor decides that greater value can be achieved through a different operational or financial strategy, operational investors are not averse to seeking the necessary board seats and management changes.

One such group, according to Mr. Park, is Boca Raton, Fla.-based Sun Capital Partners Inc., which recently purchased the Friendly Ice Cream Corp. in Wilbraham, Mass., after Friendly was targeted by the activist Lion Fund **Previous HedgeWorld Story**. Sun, which also recently purchased the Boston Market restaurant chain from McDonald's Corp., on Thursday [Sept. 20] extended an unsolicited offer to buy apparel company Kellwood Co.

Then there is the "reluctant activist," which prefers informal alliances with "pure activists" to do the dirty work and rattle the cages of a company's management and board. Often reluctant activists are large, deep-value investors that have built up a stake in a company over a long period of time, and for whatever reason have lost faith that management will be able to lead the company to its greatest value. These investors are the newest class of activists to appear on the scene, Mr. Park wrote, and they make pure activists more powerful.

Pure activists are those of the pugnacious press releases and colorful 13D filings. They are the Pirate Capital LLCs and the Lion Funds, printing T-shirts and taking out billboard advertisements to build pressure on company executives. Often, Mr. Park wrote, these activists will be pursuing proxy contests at multiple companies simultaneously, and tend to be viewed as short-term investors with a one- to one-and-a-half-year investment time frame. Whenever a pure activist takes a stake in a company, according to Mr. Park, that activist has an event in mind.

When it comes to companies targeted by activists, things are simpler. "There are two types of companies when activists start poking around or have taken a toehold," Mr. Park said. "There are the companies and management that are very interested in understanding who these activists are and how they operate and what can be done about it…. The other companies are in denial."

The latter may even have had some conversations with activists and feel like they have a good rapport, but when the activist eventually decides to turn up the pressure, it's usually too late to try the proactive approach. "When the activist turns up the pressure and decides they want board representation, most of the time they know they can win," Mr. Park said.

In his experience, companies that do proactively engage the activists have found that the only thing that keeps them at bay is to improve the value of the company—a dividend distribution, a share buyback, some combination of the two, or divesting assets. "In the companies I work with, we've been successful in a few cases of improving value and keeping activists satisfied, so far," Mr. Park said. "But it only takes one or two quarters of bad results and you're in the thick of it again."