

From: "[REDACTED]"

To: David Neuhauser <[REDACTED]>

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 Activism Feature



Activist Hedge Fund Opportunities Outlook

4 February 2018 [Rebecca Hampson](#)

Alpha Week

The first half of 2017 was dubbed the 'super campaign' year in the activist hedge fund space on the back of a number of high profile activist campaigns from leading hedge funds. Trian took a stake in Proctor & Gamble, **Jana** campaigned for Whole Foods to sell [REDACTED] - successfully, and **Marcato Capital** won its proxy fight at Buffalo Wild Wings. According to data from ActivistMonitor, the first half of 2017 in the US was dominated by what it termed super campaigns on companies with market caps above \$10bn.

Yet not all super campaigns were successful. **TCI** failed in its move to oust the chairman of the London Stock Exchange, **Greenlight Capital** failed in its campaign to split the company's stock and get a seat on the board at General Motors and **Pershing Square's** Ackman didn't get voted onto the board of payroll processing firm ADP.

However, while so-called super campaigns dominated the media more activist hedge funds ran last year than ever before, data from Preqin shows that there are now 916 activist hedge funds in operation, up from the 897 in 2016 and 656 in 2012. Last year was also the best for performance since 2013 with activist hedge funds returning 13.32 and market watchers now say that most opportunities lie in established, small cap companies.

Why small caps?

Small companies inherently have less visibility, including on their assets, valuations, and costs. This is unlike a large company like Apple Inc. that has the resources for anything they need to evaluate and analyse. Management in smaller companies is also, typically, not as experienced as those in larger companies.

Bruce Goldfarb, President and CEO of proxy solicitor firm **Okapi Partners**, says: "Activists tend to target companies that have gotten set in their ways and become too comfortable with their shareholders to understand that change needs to be made in order to create value."

Other market participants agree that there will be opportunities in activism because there will always be small companies that have management in need of a "shake-up".

Phil Goldstein of **Bulldog Investors** explains that often they find that an owner and family will dominate a board and are abusing the process. "So then they are worth looking at. There will always be companies that draw the attention of investors."

While the general view seems to be that there are no specific sectors that stick out as having more undervalued stock, it does come down to what sectors the hedge fund specialises in and certain changes within those industries.

Livermore Partners founder David Neuhauser says that whether they take a long or short view depends on the company; a lot is cyclical. "You can't know how something will behave exactly, it depends on the situation. There are a lot of things that are cheap but it doesn't mean they are undervalued."

Sector opportunities

The emergence of new industries, such as crypto currencies and blockchain technology, and the legalisation of marijuana in Canada means that there has been a rush of new entrants.

Ben Axler, founder of **Spruce Point Capital** a short selling activist hedge fund, explains that this results in certain companies changing their names and business focus to leverage opportunities, but that they have no proven business model.

"The challenge becomes rooting out the companies that are real vs. the ones being promoted. Small companies generally have higher business and financial risks, greater share price volatility, and less research coverage from the large stock brokerages," he says.

Axler focuses on the short side because of the current market highs, the ████ 500 is up (approximately 7%) this year. He says: "The higher share prices rise, the more stretched the valuations, the better the short-selling environment becomes for us."

Long term/Short term investment

Activist investing it is often criticised for its aggressive short term approach, but an increasing number of activist investors, are now taking a longer term view, which can have a better impact in helping struggling companies fix structural management issues and increasing shareholder values.

Goldfarb says they are finding that activist investors actually intend to hold their shares in the company for longer time periods than the average active mutual fund manager.

"In order to win a proxy fight these days you have to show a real strategy to create value at a company. Financial engineering and other short term moves (without a long term value component to the strategy) often don't resonate with other shareholders," he says.

Activist Monitor data showed that in the first half of last year there was a drop, (53% on H1 2016) in settlements between activists and companies.

Goldstein explains: "Change is always difficult and because of this we often get hostile reactions from boards and CEOs when we give notice of a proxy contest. I've been sued a lot. We find that they [CEOs] often run straight to their lawyers rather than the shareholders to find out what they can do to fix the problems."

The future

With the opportunities in the small cap space it is easy to see why more activist hedge funds are popping up. There are also supportive factors that are likely to play a hand in it. It is likely that (research based) activist investing has a long-term future because it is hard to replicate it with technology.

Axler says: "Things like background checks on management (and board members), written requests to governments for specific data and details (e.g. environmental and securities regulators), product testing - all these things require human contact and they are not easily obtained (or automated). We believe that old fashioned due diligence will never be disintermediated."

There has also been a significant amount of capital allocated to activist strategies over the past several years and investors are becoming increasingly interested in having a voice in the boardroom to create value at the companies in which they, or their investment managers, invest.

Goldfarb adds: "The success of many large and high profile activists has served as a catalyst for other managers to become more active at the companies in which they invest. What's more, very large traditional asset managers such as

