Tiburon Capital Management

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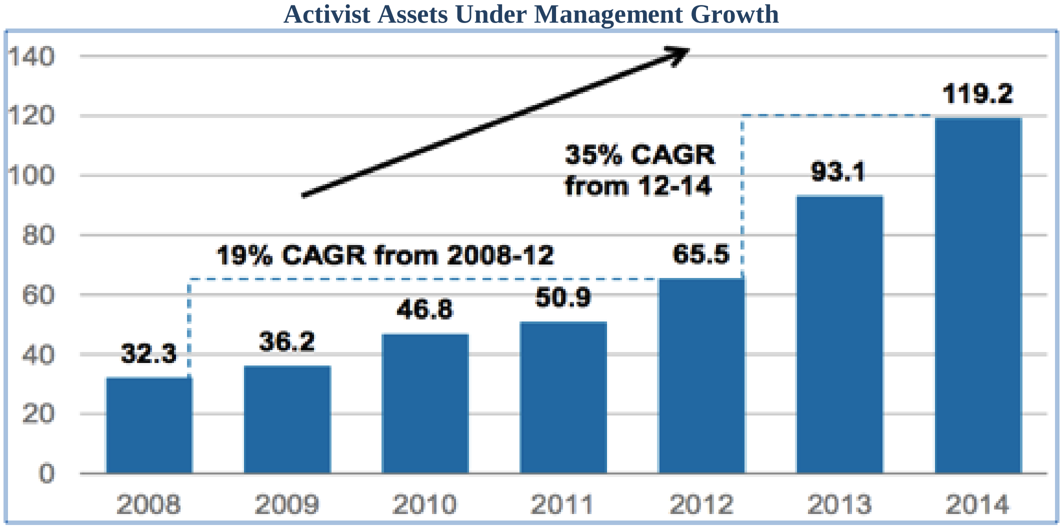
The Coincidence of Activism and Shareholder-Friendly Corporate Activities

There are many drivers converging to hasten shareholder-friendly events among public companies worldwide. To our thinking, since the *Great Recession*, better corporate stewardship, heightened community of interest between managements and stakeholders through compensation plans tied to share performance and protracted low interest rates and asset reflation via global quantitative easing created a perfect environment to foment shareholder-friendly events.[1] Concurrent with this organic evolution, managers who've visibly pressed for such behaviors have performed well and raised significant amounts of money in the process. However, it seems likely that the drivers of these events are independent of activist's campaigns and their attributed successes. Event-Driven, as a strategy broadly, has and should continue to outperform. The *coincidence*, however, of activist involvement and the occurrence of shareholder-friendly events suggests continued flow of investor capital into activism and further campaigns and outcomes (largely notwithstanding activist doings).

Activist Assets Under Management Growth



Source: Morgan Stanley

Activists as Financially Interests Actors, Among the Many

We will not enter into the cocktail party or op-ed arguments - good, bad or indifferent - about the role of activism in markets and the ramifications for companies and social good. Suffice it to say the activists are financially interested parties, as we define them, utilizing our proprietary investment methodology.[2] And as part of any review we do of a company through our lens, we consider all financially interested *Actors*, including activists, if any are involved. In most instances, the positions in our portfolio with activist involvement pre-date them (*PepsiCo*, *Ashland*), in other instances we may agree with their thesis and believe they've been given short shrift (*Dillard's*), yet in other instances, the mistakes made by activists (and then exacerbated in swollen market price) gives us new-found catalysts supporting a short thesis (*Bob Evans Farms*).

Activism is a *Tool* of Event-Driven Managers, Not a Separate Strategy

It is our position that activism is not an event – it is merely a tool for hastening or enhancing the probability of a potential catalyst. I am hard pressed to understand the ardor for investing more narrowly in a *tool* of a

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[1] See Tiburon White Paper, *The Seismic Shift towards a New Corporate Social Contract*, Lupoff, Shark Bites, Vol 4, Article 1, September, 2013 http://tiburonholdings.net/uploads/The_Seismic_Shift_towards_a_New_Corporate_Social_Contract_Final.pdf

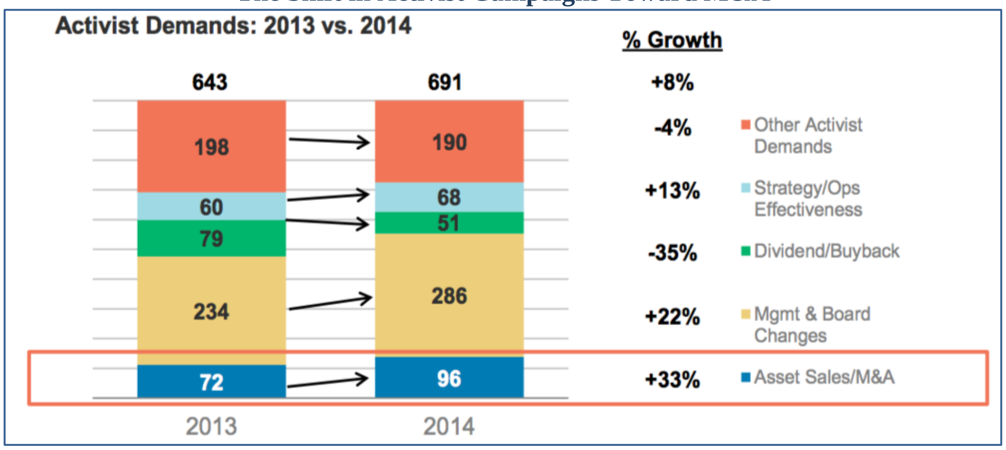
[2] Tiburon utilizes a proprietary *BRACE* investment methodology. *BRACE*, an acronym standing for each of 5 elements that must be met as part of an acceptable investment thesis, includes a behavioral element: "A" Actor's Assessment – requiring a review of potential "R" Revaluation Catalysts through a game theory assessment of how all financially interested Actors ("A") may behave, shaping the probabilities of the Revaluation Catalyst. Contact us to discuss further.

strategy versus a broader *event-driven strategy* allocation. I believe there is moral hazard in a narrowly defined activist approach and that arguably, "activism" returns are coincident with or correlate to the underlying events already likely, rather than causing them.

Why the Concept of Activism - *the Tool* - Matters with Regard to Unlocking Returns from Events

Of the various shareholder-friendly activities pressed by activists, it appears that M&A initiatives are on the ascent. According to *Morgan Stanley*, rising activist demands for asset sales, carve-outs and M&A grew by 33% from 2013-14, representing 15% of overall campaigns, 300 bps higher than the 11% share in 2013. Demands for dividend initiation, increase or special payments and share buybacks have fallen by nearly the same percentage.

The Shift in Activist Campaigns Toward M&A



Source: Morgan Stanley

Returns from M&A as the event, are typically significantly greater than those from dividend initiation, increases and/or special payments. Often they are connected. We frequently see companies committed to an M&A initiative and then plow back the cash received in the form of share buybacks, dividend initiation, increases and/or special payments, giving holders the heightened return from both. The potential for higher returns from successful M&A campaigns and the consequent mark-to-market increases in holdings when activists publicly disclose the plan can cause a self-fulfilling prophecy: share price appreciation to near full (or to fuller) value well in advance of any real changes suggesting a greater probability of outcome.

In other words, event-driven managers (vs activists more narrowly) participating in the same situations can more dispassionately trade the positions when the risk/reward skews in irrational ways, well before any catalyst unfolds. With strict price targets, why would a manager stay in a situation that is full value, pricing in a catalyst that has yet to occur (absent a change in other assumptions) unless the narrowness of their "strategy" compels them? When do you publicly admit "we were wrong" or say "this is good enough"?

The Moral Hazard in Narrowly Defining an Event-Driven Strategy by the *Tool* of Activism

Among the myriad potential catalysts that can unlock value and move securities (long or short) to fair price, why would you choose to limit yourself to those where waging an activist campaign is the basis solely? This argument may be a bit narrow as surely some self-identifying activists maintain broader portfolios and create alpha from events where they cannot, or it is unnecessary for them to rattle the cage of management, either privately or publicly. Given our thinking that activism is a tool of event-driven managers, we have had numerous meetings with managements over the years where our take away was they had every intention of considering, ultimately undertaking exactly what we sought. What purpose then, in publicly pressing for what inevitably comes (other than marketing)? Conversely, when management is steadfastly and diametrically opposed to a plausible catalyst, an activist campaign can shed light on the logic and benefits of proposed actions, but ironically, isn't it simpler, cheaper (on a time and cost basis) to participate from afar while someone else is hurling the bombs? The very nature and act of any exhaustive campaign, particularly if waged publicly and on larger positions, give rise to the moral hazard that the manager increasingly, in light of the failure of his/her cause, seeks and finds support in data (confirmation bias) to justify the time and effort and then serves up that Kool-Aid for their colleagues and investors. Finally, as mentioned above, when activist public entreaties help drive share price to full value before the contemplated event's occurrence, managers that are purely Event-Driven and agnostic to appearances, can simply harvest gains with timely exit. The activist may have the moral hazard of needing to hold positions because of the public nature of their skirmish.

The Coincidence of Activism and Shareholder-Friendly Factors

There are many drivers converging to hasten shareholder-friendly events worldwide. These drivers are independent of activist's campaigns and their growing asset growth and attributed successes. Their *coincidence*, however, suggests further hastened and enhanced shareholder-friendly campaigns and outcomes. There are, as we have discussed many times, the three arrows in the quiver which companies presently have: i) more cash on the balance sheet than ever, ii) access to cheap financing, and iii) their own high share price as a currency. Additionally we note the following dynamics/conditions:

- A protracted global low interest rate environment pressing all investors to seek higher returns
- High stock market correlation driving lackluster hedge fund performance
- Corporate underperformance
- Investor preferences for *pure-play companies*
- Perceived activist attributed success to date in effecting change and creating performance
- Institutional shareholders supporting activist agendas

For the time being, one will beget the other. Activists will call for shareholder-friendly events, particularly M&A. Companies will consider them (many prior to activist's demands). Successes due to increased market pressures and visibility, ROIC considerations, will favorably influence activists' AUM growth, despite the moral hazard of activism - the *tool*, masquerading as activism - the *strategy*.

We and others, as more dispassionate, agnostic and broadly defined event-driven managers, can be the beneficiaries of this exceptional event-driven environment and the behaviors of the narrower interests of activists as "A" financially interested *Actors*, and yet always reserve activism as a *tool*, ourselves, for the select moments that it can help us to achieve desired outcomes among positions in our portfolio.

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