

## Activism means more than hissy fits and egos

By Whitney Tilson

Published: February 23, 2006

The dialogue between companies and their big shareholders is growing more contentious. Activist investors – often large hedge funds but also mainstream money managers such as Fidelity and Franklin Templeton – have taken on a growing list of what they consider to be mismanaged companies in agitating for change. Few targets are immune, and include such everyday names as General Motors, Time Warner, McDonald's, Blockbuster and Circuit City.

In many ways the rise of shareholder activism is a natural – I would argue, long overdue – product of the times. Shareholders slumbered through the boom years of the 1990s while companies fudged their numbers, leveraged their balance sheets pursuing pie-in-the-sky growth, and compensated executives to a nauseating degree. To their credit, however, when the bubble popped, managements and boards – for the most part responsibly – de-levered balance sheets and started piling up cash.

The result today is that corporate America as a whole is overcapitalised relative to the stable economic conditions. Much activism stems from fundamental disagreements between large shareholders and company management over how this abundance of capital should be allocated.

I have long believed the corporate world is plagued by poor capital allocation decisions. Most chief executives rise to that position by being good operating managers. Few have extensive experience or training with capital allocation. What CEO wants to return excess cash to shareholders when it could be used to expand his or her empire? As corporate boards are typically stacked with CEOs of other companies, they tend to suffer from the same blind spots. Thus, faced with investors, whose job after all is nothing more than capital allocation, it's not surprising that sparks often fly.

The battle lines over increased shareholder activism are sharply drawn. Jonathan Jacobson, who with partner Richard Grubman manages \$8bn for Boston's Highfields Capital, states the investor case plainly: "Poor management is able to persist because shareholders aren't willing to do anything about it," he says.

New York law firm Wachtell, Lipton, Rosen & Katz, on the other hand, pulls no punches in stating the anti-activist position in a recent memo to corporate clients. "Expose the attackers for what they are, self-seeking, short-term speculators looking for a quick profit."

All shareholder activism, of course, won't be productive. "Much of what you see today is 'buy shares today and tomorrow throw a hissy fit'," says ValueAct Capital's Jeffrey Ubben, who has a long and successful track record of activism. "Activists are going to need the capital base, experience and credibility to follow through, by buying the company or going on the board to help fix it, if steps aren't being taken to address their concerns. You'll need to be more than a yeller and screamer whose biggest asset is that you don't care what anybody thinks about you."

Regardless of the excesses, activism is not a fad. The stakes are too high to stand by while companies fritter away billions of dollars. Savvy investors are recognising the opportunities by piggy-backing on activists' efforts. My portfolio consists of many companies I find fundamentally undervalued in which I expect activism to play a role in the value being realised.

One of our most profitable investments last year (which we still own) was Wendy's International. Early in the year, Bill Ackman of activist hedge fund Pershing Square recognised that, with the stock in the high \$30s, the company's Tim Hortons subsidiary was worth nearly the entire stock price and, in addition, substantial value could be unleashed if Wendy's refranchised many restaurants and used the proceeds to buy back stock. We estimated Wendy's was worth at least \$65 per share if the company adopted his plan.

Ackman acquired more than 9 per cent of Wendy's and publicized his recommendations. At first it was unclear how the company would react. If you were the CEO of Wendy's, would you want to spin off your best, highest-growth business?

Eventually Wendy's adopted Ackman's entire plan and the stock has risen to about \$57, up more than 50 per cent over the past year. In an interesting twist, a second activist investor, Nelson Peltz of Trian, appeared on the scene calling for operational changes that he claimed, if implemented, could boost the stock to as much as \$89. We think there's enough merit to Peltz's plan that we continue to hold the stock.

Well-managed companies with independent boards have nothing to fear from activist shareholders. Poor managers and passive boards should expect to hear a lot more from those whose money is at stake. Which is exactly as it should be.

*Whitney Tilson is a money manager who co-edits Value Investor Insight and co-founded the Value Investing Congress.*

*E-mail: [feedback@tilsonfunds.com](mailto:feedback@tilsonfunds.com)*