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SECTOR
IN FOCUS:
BASIC
MATERIALS

JEFF
EBERWEIN

STARBOARD
AT WAUSAU
PAPER



ACTIVISM MONTHLY



Activist Insight

www.activistinsight.com



Editor's letter

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As activists start to build their stakes and announce their slates for proxy season, we've been speaking to various investors about how they choose their targets. The results say a lot about the growth of activism in the US in recent years, and perhaps also something about the low profile of some activists in Europe.

Of course, all activists have their proprietary screens, which analyze the fundamentals of their targets. An underperforming stock is an obvious red flag. Indeed, Casablanca Capital recently pointed out that its latest target, Cliffs Natural Resources, was the worst performing stock in its class in 2013.

Yet the thing that sets American activists apart is the increasing extent to which they are invited by long-standing shareholders who are unhappy with the direction in which management is taking the company. One activist told *Activist Insight* he had been approached by a company's employees over weaknesses the board were unwilling to confront. A recent proxy contest in Canada owes its origins to the dismissal of two executive officers.

These combinations make sense. Institutional investors may not have the resources or expertise to propel an intransigent board in a given direction, and activists like to know that they are going to gain traction with shareholders, especially if they have to fight a proxy

contest. Increasingly, therefore, boards should be worried when investors withhold votes this annual meeting season, even if an activist hasn't made itself known. They might find that a little rebellion is all the invitation an activist needs.

“Increasingly, activists are being invited into stocks by longstanding shareholders”

There has been a considerable amount of talk in recent weeks about how activists get along with each other. The topic is important, if only because the chances of activists finding themselves in the same stock are going to increase over the next few years as the economic recovery makes it more difficult to identify undervalued stocks. Many activists will want to pursue their own agendas, having run their analysis and decided on a strategy. In such cases the activist with the bigger stake is likely to take the lead, something common to campaigns at Wausau Paper and Darden Restaurants.

However, the potential for synergies is real, even if activists will be shy about saying so for fear of being classed as an investment group. Smaller activists can add weight to each other's campaigns, but can also be the catalysts for settlements between corporates and

bigger activists. In turn, bigger activists can pass on advice and investment ideas, as they amass greater assets and target larger stocks.

This month's edition of *Activism Monthly* contains an interview with Jeff Eberwein, a relative newcomer to activism who has made pairing up to fight proxy contests something of a speciality. Jeff's Lone Star Value Management is the busiest activist of 2014 by the number of new campaigns, all the more impressive for being a relatively small operation. His perspective on starting out as an activist is particularly pertinent, with 2013 seeing more activist funds launched than any year since 2009.

We also look at the Starboard Value campaign at Wausau Paper, where the company clearly feels the activist has made one request too many, and profile activism in the basic materials sector.

We're hopeful that you will enjoy the new format to the newsletter. Thanks to the many activists and advisory firms that have offered insights into their activities, which has enabled us to expand our coverage. Should you have an idea for a feature or contribution, please don't hesitate to get in contact.

Industry in focus: basic materials



Activist investing in the basic materials sector is a topical subject. Over the last five years, a total of 50 activists have led campaigns to shake up 68 companies, and last month Casablanca Capital became the latest, targeting global mining company, Cliffs Natural Resources. The company says it is open to new ideas, but some of its actions may suggest otherwise. In this sector profile, Activist Insight looks at the reasons activists are targeting these companies.

Basic materials themselves are a popular buy during an economic recovery, and according to Activist Insight data the number of new investments in companies in the materials sector has been rising steadily. In 2010, just 4% of new investments were in mining or energy stocks. By 2012, however, the proportion of investments in basic materials had risen to 14%, and stayed there over the course of last year. In 2014 so far, 10% of campaigns in which activist actions were identified have been in the basic materials sector,

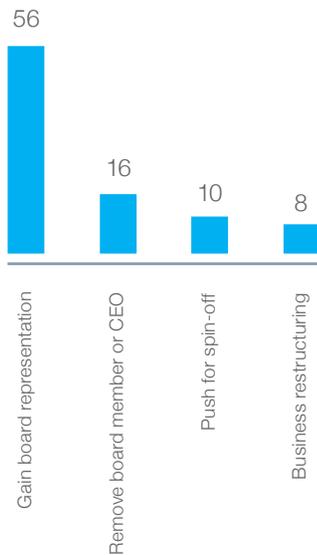
and Fitch Ratings has warned that increased activism may be affecting cash flow in the industry.

Meanwhile, a number of high-profile campaigns in 2013 raised the profile of activism in basic materials. Clinton Group won seats on the board of Stillwater Mining Company after a protracted proxy contest, while JANA Partners failed to win representation for their nominees at Canadian fertilizer producer Agrium.

Indeed, JANA has been by far the most

prolific activist in the sector. The hedge fund, founded by Barry Rosenstein, has run activist campaigns at seven companies in this sector since 2010, compared to five for Carl Icahn and four for the London-based Audley Capital. During 2013, JANA pushed Ashland to declassify its board and start selling non-core divisions. In December, the activist doubled its stake in QEP Resources after the company reportedly adopted plans to acquire assets in Texas' Permian Basin and sell its Field Services and Midstream Divisions. In recent months, it reports

“JANA PARTNERS HAS BEEN BY FAR THE MOST PROLIFIC ACTIVIST IN THE SECTOR WITH SEVEN CAMPAIGNS”



Most popular tactics of activists in the basic materials sector since 2010, by frequency of employment

are correct, the activist has taken a stake in Cameron International Corp, a Houston-based supplier of equipment to oil and gas exploration companies.

So, what are the activists interested in? First, companies in the basic materials sector are often overcomplicated, having vertically integrated everything from pipeline to accommodation businesses. Activists often look at the potential to create value from spinning off these businesses. For instance, last year Elliott Management called on Hess Corp to sell its gas station network and become a pure-play exploration and production company, while JANA Partners prevailed on Oil States International to spin off its accommodations business, with a future REIT a distinct possibility.

Second, the entrepreneurial origins of exploratory industries often lead to

Case Study - Hess Corporation

Elliott Management disclosed a stake of less than 5% in Hess Corp in a January 29, 2013 letter, which was circulated among all shareholders. It wasted little time in announcing that it would fight a proxy contest at the global oil production and exploration company, rubbishing Hess's initial response, which was to announce the exit of its refining and terminal business.

Elliott's case illustrated the vulnerability of the company to activism. Noting that the company had seen significant rebellions in previous annual meeting votes and had underperformed its peers, it said new board members could refocus the company. The activist retained an expert to analyze the company for hidden value, concluding that its "illogical, difficult to value configuration of assets is evidence of a

lack of focus that breeds poor execution, encourages appalling capital allocation, and results in perpetual undervaluation by the market."

As the campaign progressed, Elliott held shareholder "town hall" meetings and repeated its case. Californian teachers union CalSTRS backed the activist, as did ISS and Glass Lewis, although Egan Jones supported the company.

On May 16, 2013, the company announced that it would add Elliott's five nominees to the official proxy. The much-vaunted doubling of the share price has yet to materialize, with shares up 10% since Elliott disclosed its stake, against 16% for the S&P 500 over a comparable period.

deep-rooted CEOs, which can lead to clashes with assertive shareholders. As a result, activists have often sought to force change at the top. According to Activist Insight data, since 2010 10% of campaigns in basic materials companies have sought to remove a Chairman or CEO. SandRidge Energy's Tom Ward and Chesapeake Energy's Aubrey McClendon can certainly testify to the effectiveness of activism in that respect, while the intervention of Indianapolis-based Two Fish Management in Barrick Gold Corp led Chairman and Founder Peter Munk to bring forward his retirement.

Another attraction is that, in the US at least, energy companies can apply to become Master Limited Partnerships. These partnerships are often exempt from corporate taxes and pay surpluses as dividends, encouraging the return of capital to investors. Sandell Asset

Management was one of the many activists to use the tactic in 2013, in this case at Spectra Energy Corp.

Yet another factor that could become increasingly important in 2014 is the worldwide operations of these companies. A recent sell-off in emerging market currencies has raised the prospect of a stronger dollar, which will reduce the value of overseas earnings. Given that global energy firms in particular are under pressure from shale gas exploration in the US, there could be more scope for retrenchment.

In short, there is plenty of scope for activism to continue strongly in this sector – at least until the hankering for commodities peaks.



The definitive resource on activist investing

*Market-leading commentary,
analysis and profiling of all activist
situations worldwide*

Detailed profiles of over 200 activist investors worldwide, including investment strategy, activist holdings and performance.

Live and exclusive news service and alerts system, keeping you informed of all activist situations worldwide.

Detailed market analysis, intermediary profiling, bespoke data requests and much more...



Activist Insight

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A lone star activist

An interview with Jeff Eberwein of Lone Star Value Management

Not many activists run as many as five proxy contests a year, still less when their team consists of two members. Jeff Eberwein is no ordinary activist, however. His Lone Star Value Management has the most newly disclosed positions in 2014 according to Activist Insight's count, making entering the activist investing game look easy.

"People who see my resume would scratch their heads based on my previous history," says Eberwein of his 'conversion' to activism. As an equity analyst at Schroders and then Citibank, followed by stints as a portfolio manager at Viking Global and Soros Fund Management, he would seem an unlikely activist. "But people who know me well know I like detailed models and getting my hands dirty. Activism was a natural progression."

After leaving Soros, Texan-born Eberwein became an activist, amassing a number of positions that he has now folded into Lone Star. Now he's managing over \$90 million, and targeting a portfolio of 15-20 stocks in the small-cap segment of the market – an area activists say is rife with poor boards, poor management and inertia. The range and variety of Lone Star Value's filings is impressive. He's looking to take on staff at his Connecticut HQ this year, and outsources some of his research, but how does Eberwein manage to find so many candidates for

his board slates? "One of the benefits of working on Wall Street for twenty years is getting to know a lot of ex-CEOs. Industry expertise is important to a slate, but I like to have a mix of people who are good at finance, or dealing with shareholders, or on the operating side. Those are the best teams."

“It’s often about working harder than the other side and two activists can cover more ground than one”

The job is made easier by a strategy that is still rare among activists – partnering up with other investors. So far, Lone Star has run joint campaigns with Engaged Capital LLC at Rentech Inc. and JCP Investment Management LLC in The Pantry Inc., a North Carolina chain of convenience stores. "A lot of activism is not exactly rocket science," Eberwein told Activist Insight recently. "It's often about working harder than the other side, and two activists can cover more ground than one."

Recently, media attention has started to focus on activists who go into stocks with different agendas, or who appear to be competing. Securities regulations often deter activists from publicly expressing sympathy with each others' objectives, for fear of being labeled as an investor group and being hit with

restrictions on how quickly they can divest their stakes.

Eberwein's experience has been of a friendlier community. He says he has talked extensively with one big-name activist pushing a company to form a REIT for its real estate about his campaign at The Pantry, and has been given names of people who specialize in creating and managing REITs. As activists with swelling assets go on to target larger stocks, they often pass on investment ideas to smaller funds, and vice versa, according to Eberwein.

As proxy season begins to take off, Eberwein seems relaxed about the work ahead. "Some [proxy contests] will settle, others will go to a vote." Even longer-term, he is optimistic, saying that to maintain his portfolio he needs just five-to-ten ideas a year, an easily-achievable target. "In small-cap land, someone is always underperforming because of a bad board."

NOTABLE LONE STAR CAMPAIGNS

The Pantry (with JCP Investment Management)

Rentech (with Engaged Capital)

Hudson Global (with Bradley Radoff)

Callon Petroleum Company

Miller Energy Resources

Starboard at Wausau Paper



It is still common, albeit thankfully less so, for activist investors to be derided as short-term. Yet Starboard Value LP's proxy contest at Wausau Paper is a reminder that many activists won't exit a company until they've seen through their objectives. The activist has settled with the company and gained board seats for two years in a row. Yet, the chances of this year's proxy contest settling seems more remote, however, as it would give Starboard a majority on the board.

Starboard first filed a Schedule 13D at the company in July 2011, around a month after meeting with the company and presenting its investment thesis. While congratulating the company on the "highly defensible niche market" it had cornered in the tissue market, the activist wanted a moratorium on a \$220 million investment, which it said posed a serious risk of breaching the company's debt cap, and for the company to look at divesting its Paper business. After increasing its stake to 9.3%, Starboard

settled with the company, gaining two board seats in February 2012.

In January 2013, Starboard wrote again to the company's Chairman, Thomas Howatt, detailing "repeated requests" for the company to sell either the Technical Paper business or the whole company. Howatt responded by expressing his shock at the activist going public after months of private talks, and defended the actions taken by his board since 2012. In May 2013 the company expanded Starboard's representation on its board to four seats, reflecting its ownership of 14% of the company.

Despite the company selling the Technical Paper business in mid-2013, the divergent strategies pursued by the company and Starboard emerged again in October 2013. The activist said it was disappointed to hear that CEO Hank Newell had returned to a mantra of "investment for growth," introducing overhead reductions, a relocation and a share buyback as the

next stage in its campaign. Starboard's Jeff Smith said investors needed clarity, to ensure that the company was not "once again doing the bare minimum that it believes is necessary for management to receive credit for "doing something" without fully committing to the necessary steps to unlock significant value for shareholders."

The current situation raises questions over who is to blame for the company's continued underperformance, now it is the pure-play tissue business. Starboard has alleged that the company has continued to invest in failed ventures, and that future earnings growth should come through cost-reductions. Having already gained four seats on the nine-man board in the past two years, the activist is now looking to add another three. Wausau Paper says that would be "disproportionate and inappropriate", adding that it is "fully committed to creating further value and acting in the best interests of our shareholders."



Barington Capital Group called on **Darden Restaurants** to split the roles of CEO and Chairman and paved the way for a rival activist to implement its plan at the company. On a conference call, the activist's CEO James Mitarotonda said **Starboard's** slightly different plan for a company division "could also work very well." Although Barington unveiled its plans first, Starboard has almost twice as large a stake and is therefore in pole position.

Altai Capital Management bought a 5.5% stake in **Wausau Paper**, where **Starboard Value** is seeking further board representation. Altai said it intended to have talks with the company's management and with Starboard about potential changes to the board. While its support for Starboard is far from guaranteed, Altai says it believes its fellow activist has made "a convincing prima facie case" that its three-man slate should be elected.

In January, **Pershing Square Capital Management** was reportedly up 3.8% leading many other investors. The New Year has started brightly with the prospect of a takeover premium at **Beam Inc.** The drinks maker, known for Jim Beam whiskey, is being taken over by **Suntory Holdings Limited**, with various news sources crediting Pershing with making the deal possible by calling for the breakup of **Fortune Brands**, the then owner of Beam, in 2010.

NOTABLE NEW INVESTMENTS IN JANUARY

| <i>Activist</i> | <i>Company</i> | <i>Shareholding</i> |
|--------------------------|--------------------------|---------------------|
| Altai Capital Management | Wausau Paper | 5.50% |
| Casablanca Capital | Cliffs Natural Resources | 5.20% |
| Corvex Management | Signet Jewelers Limited | 7.80% |
| Elliott Management | WM Morrisons | <1.00% |
| Sandell Asset Management | WM Morrisons | <1.00% |
| Carl Icahn | Ebay | 0.82% |

Sandell Asset Management cut its stake in **Bob Evans Farms** to 5.30%, from 6.50%. The news came after the company reversed requirements, first introduced in 2011, for a supermajority to make changes to the company's bylaws or board. Though Sandell claimed to be "pleased" with the changes, it went on to say that "further, comprehensive strategic change is necessary to unlock maximum shareholder value."

Elliott Management took a stake in **F&C Asset Management** and may be preparing to agitate for a better offer. The activist holds a 3.2% stake in the asset manager and paid a slight premium to the price offered by Bank of Montreal on 7.7 million of the 18.5 million shares it purchased in total.

Elliott also released a statement on its activities at **Juniper Networks**, saying it was "gratified by the absolutely overwhelming support" it had received from fellow shareholders. Meanwhile, **Riverbed Technology Inc.** rejected a takeover offer from the activist that valued the company at \$19 per share. US pharmaceutical distributor **McKesson**

announced that it has acquired 75% of **Celesio**, having reached agreement with Elliott to purchase the activist's shares. The activist reportedly made most of its profits on bonds issued by the company, rather than the shares. Elliott also gained two seats on the board of **Compuware Corp.**

Elliott and **Sandell** reportedly built stakes in **WM Morrisons**. Speculation centred on a potential spin off of the British supermarket chain's real estate, most of which is directly owned by the company.

Keith Meister's **Corvex Management** had a busy month, unveiling a new stake in **Signet Jewellers**, buying more of **Williams Companies** and increasing its attacks on **Commonwealth REIT**, where it is running a consent solicitation. The activist is also rumored to be one of three on the share register of car-rental firm **Hertz**.

January in numbers

ACTIVIST FIRM LAUNCHES

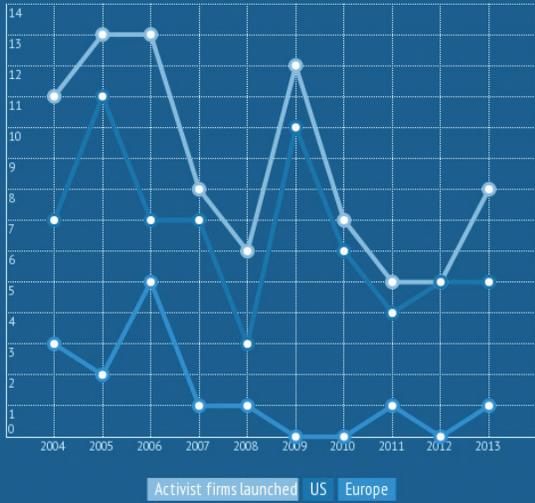


Fig. 1 shows year activist investment firms launched since 2004, when Pershing Square Capital Management was formed. Data from Activist Insight's 215 profiled activist investors. Activist Insight classifies firms as primary focus, partial focus or occasional activists depending on how regularly they engage with companies. 2013 was the best year for primary focus activist firm launches (with six) since 2004 (with seven). A primary focus activist is likely to have engaged with most of the issuers in its portfolio at any one time.

ACTIVIST STRATEGIES

GAIN BOARD REPRESENTATION



SPIN-OFF/SELL BUSINESS DIVISION



SELL/RETAIN ASSETS



COST-CUTTING



CAMPAIGNS BY SECTOR

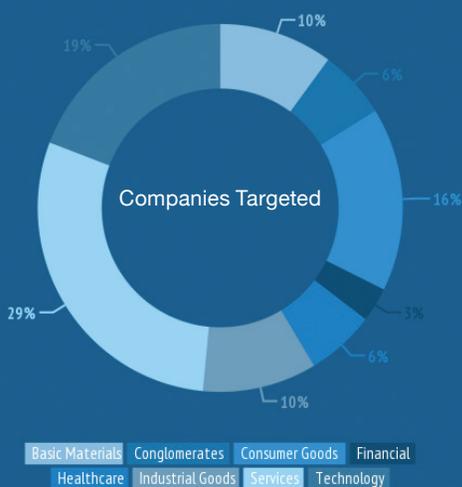


Fig. 2 Activist campaigns by sector.

12

Number of SC 13Ds filed by activists in January, down from 13 in December

65

Number of SC 13D/As filed by activists in January, down from 86 in December