



ACTIVIST INVESTING

A STUDY ON ACTIVIST HEDGE AND
THEIR CAMPAIGNS

Mark W. Gaffney for Value Walk

ValueWalk

Image Credit: www.wikimedia.org

PART ONE

The First Activist Campaign -- Benjamin Graham Unlocks the Treasure Hidden in Northern Pipeline's Balance Sheet

The year was 1926, and 32-year-old Benjamin Graham was sitting in the dimly lit reading room of the Interstate Commerce Commission, scrutinizing documents.

He had taken the train to Washington D.C. from Wall Street, where he had recently started his own investment management partnership. His reputation as a savvy securities analyst and investor was growing, but this was eight years before Graham authored the classic *Security Analysis*, which along with *The Intelligent Investor* published in 1949, would help establish Graham as “The Father of Value Investing.”

Surrounded by shelves of folders pertaining to U.S. regulation of railroads, trucking companies and pipelines, Graham was transfixed on one report in particular -- the balance sheet of Northern Pipeline Company. It was an out-of-favor, thinly-traded stock spun-off from Standard Oil a decade earlier. And what he found amazed him:

Unknown to anyone on Wall Street, Northern Pipeline had major holdings of high-grade bonds. By Graham's calculation, the company, then trading at \$65 per share, and paying a \$6 per share dividend, was holding \$95 in liquid bond assets for each share outstanding. Graham had a realization: Northern Pipeline could distribute to its stockholders \$90 per share in a special dividend with no impact on the company's operations.

Graham saw that Northern Pipeline's actual operations were comparatively small, with large profit margins, and that the company carried no inventory. There was no need for Northern Pipeline to hold the bond investments. Even after paying out a large distribution, Northern Pipeline would remain profitable and debt-free. This would be a bonanza for shareholders.

I Had “Treasure in My Hands”

Graham's discovery of Northern Pipeline's hidden assets would mark the beginning of a new era in investing and corporate governance, and earn The Father of Value Investing another distinction: The First Activist Investor.

Northern Pipeline was one of eight pipeline companies created in 1911 when the U.S. Supreme Court broke apart John D. Rockefeller Sr.'s Standard Oil monopoly. In the days before SEC mandated financial disclosure, these pipeline companies supplied only bare bones income statements and balance sheets to shareholders.

What Graham discovered -- and other investors didn't realize -- was that each of the pipeline companies also filed a twenty-page annual report to the ICC -- the agency which oversaw the country's transportation businesses. To Graham's astonishment, the ICC statements of the pipeline companies contained detailed breakdowns of millions of dollars of U.S. government securities and railroad bonds held by the pipelines. And Northern Pipeline held the most securities relative to its market price of them all.

In *The Memoirs of the Dean of Wall Street* compiled by Seymour Chatman, Graham looked back on this defining moment in the history of activist investing and remembered feeling like an explorer encountering a new world:

“Here was I, a stout Cortez-Balboa, discovering a new Pacific with my eagle eye...I had treasure in my hands.”

Graham returned to his Wall Street office and via his investment partnership began accumulating Northern Pipeline shares. By “careful but persistent buying” over weeks, he acquired 2,000 shares out of the company’s 40,000 outstanding -- about a 5% ownership position. This made Graham the largest stockholder of record after the Rockefeller Foundation, which owned about 23 percent of all the spun-off pipeline companies.

After acquiring the sizeable stake, he decided it was time to “persuade Northern Pipeline management to do the right and obvious thing: to return a good part of the unneeded capital to the owners, the stockholders.” Naively, he thought this would be rather easy to accomplish.

In the months ahead, as Graham tried to persuade and pressure Northern Pipeline management into giving shareholders their due, the securities analyst discovered what a thousand activists have confronted in the years since: Often the management of public companies has objectives other than maximizing shareholder value. And compelling entrenched, self-serving management to do “the right and obvious thing” may require dogged determination over many months or years. But the returns for shareholders can be well worth it...

Graham’s “Northern Pipeline Contest” as he described it, is a classic example of an investor challenging an overcapitalized company to return assets to shareholders, and one of the earliest examples of modern shareholder activism.

Persuading Northern Pipeline to do “the right and obvious thing” for shareholders took two years

Now a major shareholder, Benjamin Graham made an appointment at Northern Pipeline’s impressive headquarters in the Standard Oil Building at 26 Broadway in Manhattan. He met with the president of the company, D.S. Bushnell, along with the company’s general counsel, who just happened to be Bushnell’s brother. Graham related his plan for distributing excess cash to the company’s shareholders, while leaving operations intact.

But, as Graham puts it, the elderly gentlemen “proved much more resourceful in finding reasons to hang on to the stockholders’ pile of gold than ways to increase the profits.”

They had a series of objections to Graham’s plan:

- The company didn’t have the required surplus for such a distribution. Graham pointed out they could issue more shares and make a payout as return of capital.
- The company needed the surplus as working capital. Graham noted that a company doing \$300,000 in revenue doesn’t need several million dollars in cash assets.
- The Bushnell Brothers asserted the bonds were a depreciation reserve, needed for future replacement of the pipeline. The value investor suggested that using \$3.6 million to replace a pipeline doing \$300,000 of business would be crazy.

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- Next, the Bushnells said they might need the cash for expanding the business. Graham noted the company was a small part of the old Standard Oil main line and that there was nowhere to expand

Finally, having run out of arguments, the Bushnells cut to the bottom line. As Graham relates, the managers told him:

“Look, Mr. Graham, we have been very patient with you and given you more of our time than we could spare. Running a pipeline is a complex and specialized business, about which you can know very little, but which we have done for a lifetime. You must give us credit for knowing better than you what is best for the company and its stockholders. If you don’t approve of our policies, may we suggest that you do what sound investors do under such circumstances, and sell your shares?”

In years to come, Graham continued to buy stakes in public companies trading well below their true, or “intrinsic” value, then acted -- by one means or another -- to close that gap. It’s the same game plan carried out by activist investors in the years since the Northern Pipeline Contest. Invariably Graham found that management resisted his endeavors, utilizing the same basic argument as the Bushnells: Management was best qualified to judge what policies were required to run a company. And if you don’t like it, sell your stock.

A crackbrained Don Quixote tilting at a giant windmill

As Graham tells it, in the 1920’s Wall Street was largely a gentlemen’s club, governed by an elaborate set of “rules”. One of the basic rules was: “No poaching on the other man’s preserves.” This meant that anyone who was “in” -- a member of what we would now call “the Establishment” -- wouldn’t think of making any move contrary to another gentlemen member’s best interests.

In 1926 when Benjamin Graham tried to persuade a management to do something other than what it was doing, Graham said old Wall Street hands regarded him as a “crackbrained Don Quixote tilting at a giant windmill.”

However, Graham was to have the last laugh. In the months ahead, he persisted in his efforts to coerce Northern Pipeline management to distribute its bond hoard to shareholders. Though it took two years, and considerable sweat and aggravation, \$70 per share was eventually distributed to shareholders, and the total value of the new Northern Pipeline stock plus the cash returned ultimately reached a total of more than \$110 per old share. The company’s shareholders were nearly 70% richer than when Graham first discovered Northern Pipeline’s hidden value in the ICC reading room.

Today, some things have changed since Benjamin Graham’s first activist investor campaign, but many things have not. Due to financial reporting requirements, and the widespread dissemination of information, activists today aren’t likely to discover stocks with massive secret bond holdings. Values like in Graham’s day are rare.

But conflicts of interest between management and shareholders certainly still exist. While corporate governance standards have improved since the 1920’s, the management of many public companies -- either through self-interest or ineptitude -- fail to maximize shareholder value. Today, over nine decades since Ben Graham discovered Northern Pipeline’s hidden cash, activist campaigns are more common than ever.

According to Activist Insight, 758 public companies received demands from activist investors in 2016 -- a 13% increase on 2015's total of 673.

And if you think today's more efficient markets limit the profit potential of activist investing, think again. In 2016, ten activist campaigns resulted in gains of 70% or more in the target company, according to Factset. It's no wonder the investment public is fascinated with activist investing: If there's hidden value in a company -- and an activist can access it for shareholders -- it's possible to achieve exceptional returns.

Top Performing Activist Campaigns in 2016 (3 Days Prior to Announce Date to End Date)						
Primary Ticker	Company Name	Dissident Group	Announce Date	Primary Campaign Type	End Date	TR of Target: 3 days prior to Announce Date to End Date (%)
AXLL	Axial Corporation	Brigade Capital Management LP	2/1/2016	Maximize Shareholder Value	6/10/2016	238.4
CWEI	Clayton Williams Energy, Inc.	Ares Management LLC	6/28/2016	Maximize Shareholder Value	8/29/2016	117.9
HTWR	HeartWare International, Inc.	Hudson Executive Capital LP	1/15/2016	Maximize Shareholder Value	6/28/2016	117.2
CDK	CDK Global, Inc.	Sachem Head Capital Management LP	10/27/2014	Maximize Shareholder Value	7/22/2016	109.1
ANGI	Angie's List, Inc.	TCS Capital Management LLC	7/29/2015	Board Representation	3/1/2016	103.6
AMED	Amedisys, Inc.	North Tide Capital LLC	12/2/2014	Maximize Shareholder Value	8/15/2016	91.0
CAB	Cabela's Incorporated	Elliott Management Corporation	10/28/2015	Maximize Shareholder Value	10/3/2016	88.0
MFRM	Mattress Firm Holding Corp.	Berkshire Partners Holdings LLC	2/9/2016	Board Representation	8/8/2016	84.0
MFRM	Mattress Firm Holding Corp.	40 North Management LLC	2/8/2016	Board Representation	9/14/2016	82.8
PCMI	PCM, Inc.	Firoz Lalji/Najma Lalji	3/13/2014	Maximize Shareholder Value	8/4/2016	70.2
DEPO	Depomed, Inc.	Starboard Value LP	4/7/2016	Board Control	10/17/2016	65.6

FactSet SharkRepellent

Activist campaigns that ended in 2016. Ranked by target company's performance three days prior to the announcement date of the campaign to the end of the campaign.

In the following chapters, I'll explore the most profitable strategies for following activist investors and their campaigns. I'll investigate the strategies of the greatest activist investors operating today -- like Elliott Associates and Third Point LLC -- and consider the pros and cons of mimicking their moves. Obscure and first-time activists are increasing in prevalence; I'll consider ways to profit from their moves.

The 13D filing is the catalyst for activist investor analysis -- I'll explain how to analyze it. I'll discuss the merits of placing funds with activist-focused mutual funds. What about creating one's own customized activist strategy based on 13D filings? Who are the very best performing activist investors, and how do we invest alongside them?

Our goal is to discover and follow those activists who with brains, savvy and hard work are able to – like Benjamin Graham 90 years ago – pry the shareholders’ pile of gold from the hands of corporate management.

PART TWO

Investor Activism Makes Big Headlines But Where Are The Big Returns?

Though it took two years, Graham's first activist campaign was a resounding success for shareholders, increasing the value of Northern Pipeline stock, including distributions, by some 70%.

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Today, nine decades since the Northern Pipeline Contest, over \$176 billion is allocated to dedicated activist strategies, according to [Activist Insight](#). Activists targeted 758 companies worldwide in 2016, a 13% increase from 2015's total of 673. The number of companies facing public activist demands outside the United States surged to 302 in 2016, up from 255 a year before.

The activist investor's script first developed by Benjamin Graham in the 1920's -- discover an undervalued public company, accumulate a stake, then engage with management to close the valuation gap -- has evolved into a massive global investment category. Mountains of capital continue to flow into the strategy, the size of deals keep increasing, and more funds are turning to activism.

Almost every day there are headlines of a new activist battle, or of an activist "blasting" management for poor performance, or "confronting" the board. It seems activist campaigns are waged more in the media than in the boardroom.

Arguably the best film dealing with the investing world, "Wall Street" is basically the story of an activist investor campaign. Gordon Gekko, the villain of Oliver Stone's "Wall Street," was in fact partly based on Carl Icahn, who in those days was referred to as a "corporate raider" (A term he reportedly loathed). People love stories, investors included -- and activist campaigns have all the conflict and drama of great movies.

While activist headlines are dramatic -- the average Activist Investor's performance is less so

Though I enjoy a great story as much as the next person, after reading article upon article in the financial media hyping the drama of activist campaigns, I'm left wondering: Who actually profited from the 758 stocks targeted by activists last year?

Because while the stories associated with activist investing are dramatic, there's evidence that the returns generated by most activist campaigns are less than scintillating.

Typical of research on the performance of activist investors, an October 2015 review by the Wall Street Journal concluded, "Activism often improves a company's operational results—and nearly as often doesn't."

The review shows that companies confronted by activists are more likely to outperform the stocks of their industry peers. But not by much. About half of the situations in the Journal study led to better shareholder returns than industry peers for the period studied after the activist went public. In the end, the median campaign beat peers by just under 5 percent.

In a study conducted last year by FactSet, when measuring shareholder returns from 2010 through August of 2016, compared to the S&P 500 Total Return index, just 43% of activist campaigns saw the target company outperform the index one year after the campaign.

Over a longer period, the study concluded that the target company involved in the activist campaign (going back to 2010) narrowly outperformed the S&P 500 index from the activist arrival date through three years post-campaign. The target beat the S&P 500 over this time frame by 0.5 percentage points on average and beat the related FactSet industry stock by 5.1 percent.

This [2012 paper](#) concluded that “over 90% of the effect of the 13D filing on the target stock’s price is realized prior to the filing.” The implication is that by the time the 13D filing is made public, most of the gains from the activist’s involvement have already been discounted by the market. (A 13D disclosure must be filed by an acquirer of 5% of a company’s shares within 10 days of crossing that threshold. I’ll discuss 13D filings in detail in future chapters.)

However, there are also examples of studies that suggest activists have a positive impact on the short and long term performance of target stocks: In this [2013 paper](#), Harvard professor Lucian Bebchuck found there is “no evidence that the initial positive stock-price spike accompanying activist interventions tends to be followed by negative abnormal returns in the long term; to the contrary, the evidence is consistent with the initial spike reflecting correctly the intervention’s long-term consequences.”

Ken Squire manages the 13D Activist Fund. The mutual fund holds a portfolio of 20 to 40 stocks that have been the focus of activist campaigns. In a 2012 study he reviewed 114 13D filings from top activist investors in companies with market capitalizations greater than \$1 billion from April 2006 to December 2011. He discovered that the average one-day jump from a stock after an activist filed a 13D was 2.65%. But after 15 months, the price rise averaged 15.24%. Over this time period the S&P 500 returned -0.93%.

The actual performance of Squire’s 13D Activist Fund is tangible evidence that investing alongside activist investors can be a profitable endeavor. Even after annual management fees of 1.5%, the fund has an annualized return of 15.79% since 2011. Over the same period the total return of the S&P 500 has been 15.33%.

But judging by the eye-popping returns generated by some activist campaigns, there is alpha in the space, but it’s concentrated in the hands of a few managers, or hidden among the avalanche of 13D filings.

PART THREE

Use 13Ds to pull back the curtain on the operations of activists like Paul Singer of Elliott Management.

It was just after 6:30 am on November 22, 2015 and Paul Singer, President of Elliott Management, had just lost \$5 million in a matter of seconds.

Nonetheless Singer was smiling. Which might be surprising given his reputation as a nonsense activist hedge fund manager, but also because one of his firm's holdings, CabelasInc. (NYSE:CAB), had just released an abysmal earnings report, and its price was plunging in pre-market trading. At the time, Singer held an undisclosed 1% stake -- or about 753,000 shares -- of Cabelas through Elliott Management's various partnerships.

However, Singer was pleased because he intended to own more of Cabelas. A lot more. And the company's stock had just gone on sale. A stock he knew was very cheap had just become cheaper. And the price weakness on heavy volume played right into his hands -- it would allow his traders to passively and anonymously sop up millions of CAB shares.

Elliott's 1% stake in CAB was only the beginning, a toehold position. Singer's plan was to accumulate a significant stake in the retailer, then aggressively pressure management to enhance shareholder value. Elliott had chosen the retailer of outdoor recreation equipment with 84 stores in the U.S. and Canada, and a market cap of \$2.8 billion, as his latest in a long series of activist targets.

By the end of the day on November 22, Elliott controlled stock and derivative contracts of Cabelas giving the firm a 5% stake in the company.

How do I know what happened that day? Was I a fly on the wall that morning in Singer's office? Do I have contacts at Elliott Management? No, all of the above information can be gleaned or inferred from the 13D disclosure filed by Elliott Associates L.P. on October 28, 2015.

A 13D filing, or Schedule 13D, is a public document filed with the SEC when a person or entity acquires 5% or more of any company's common stock. The initial filing must be submitted within 10 days after the buyer first reaches the 5% ownership threshold.

Was I a fly on the wall that morning in Paul Singer's office? Do I have contacts at Elliott Management? No, it's all in the 13D

Unlike the 13G, a similar disclosure filed by passive 5% acquirers, the 13D is filed by an activist investor -- an acquirer with intentions to engage management and actively increase shareholder value.

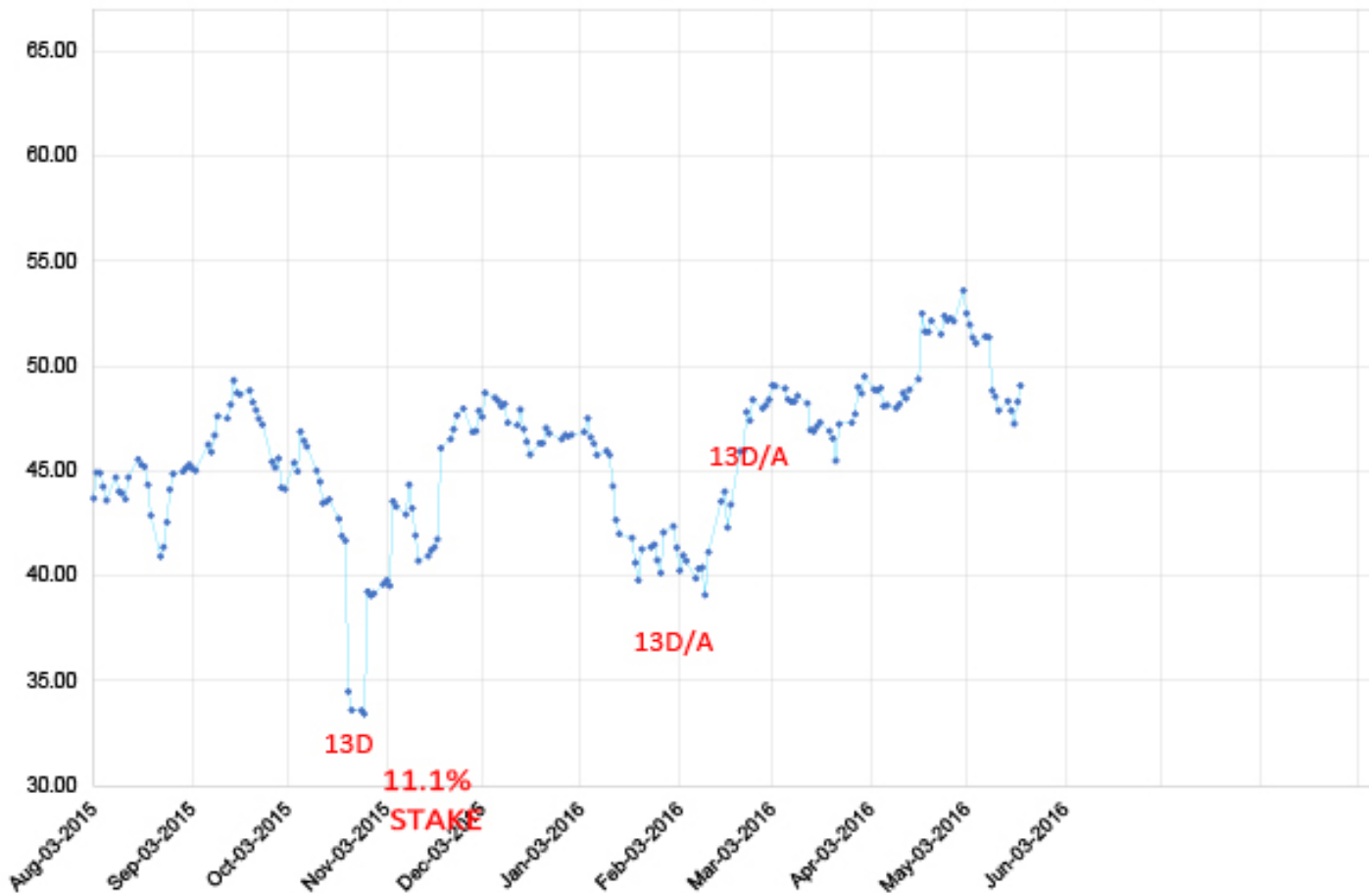
Within Form 13D, a filer is required to disclose specific details relating to the target company. For an investor seeking to analyze an activist's intentions, and assess the investment potential of the target stock, the 13D document contains valuable information.

This is the [October 28, 2015 13D filed by Elliott Associates L.P pertaining to Cabelas Inc.](#)

Singer saw in Cabelas a company that was the premier retail brand in the hunting, fishing, and outdoor industry, but had been underperforming. Still run like a family business by the founding family, Singer believed it had significant potential for improved operations. But the most valuable asset of Cabelas was its branded credit-card business. Analysts believed it could be worth \$4.6 billion -- more than the market value of the entire company at the time. Add in its real estate holdings valued at around \$1.5 billion, and with the stock trading in the upper 30s, the market was giving a negative value to Cabelas' retail business operations.

Let's examine this 13D filing, with a goal of understand the tactics of Elliott Associates as it began its activist campaign targeting Cabelas. This filing not only offers insights into Elliott's strategies during activist campaigns, but is instructive for analyzing the investment potential of 13D target stocks in general.

Cabela's Inc. (NYSE:CAB) - Elliott Associates 13D Filings



The cover page of Form 13D states who is reporting the event that caused the filing, what company it relates to, and the number of shares beneficially owned. Though filed on October 28, 2015, the Elliott 13D filing lists the “Date of Event Which Requires Filing of this Statement” as October 22, 2015.

As noted, a 13D must be filed within 10 days after the 5% threshold is reached. So in the five trading days after crossing 5% ownership, Singer continued to aggressively accumulate CAB shares. As disclosed in detail later in the filing, by October 28 Elliott controlled 11.1% of Cabellas.

The 13D cover page also describes the sources of funds used in making the purchases. In the Elliott filing, three different entities were involved in the CAB buying: Elliott Associates, L.P., Elliott International, L.P., and Elliott International Capital Advisors Inc.

Within Form 13D, the filer is required to detail seven key items related to the transaction:

- 1. Security and Issuer.** Describes the target company and the type of shares involved in the transaction.
- 2. Identity and Background.** Gives details on who is buying and the relationship between the buyers. In the Cabelas 13D, it's disclosed here that Paul Singer controls the entities buying Cabela shares.
- 3. Source and Amount of Funds or Other Consideration.** The Elliott entities are using working capital for the purchases. In some 13Ds, a bank is disclosed as the source of funds. Activist campaigns relying heavily on bank borrowing might be viewed as less likely to succeed.
- 4. Purpose of Transaction. This is usually the vital item in the 13D.** Here the acquirer explains -- often in revealing detail -- its reasons for buying the shares. Some part 4s exhibit more aggressiveness by the acquirer than others. In this case, Elliott Associates “bought the shares based on their belief that such securities are significantly undervalued by the public market and represent an attractive investment opportunity...there exist multiple pathways for the Issuer to unlock significant unrealized value...through various strategic alternatives including...a sale of the Issuer, asset monetization, capital allocation and capital structure optimization, and operational and management initiatives.”
- 5. Interest in Securities of the Issuer.** This section describes the share purchases in the target by parties listed in Item 2.
- 6. Contracts, Arrangements, Understandings or Relationships With Respect to Securities of the Issuer.** Here we see that Elliott, through partnerships, has entered into cash settled swap agreements for shares representing approximately 5.1% of Cabelas's shares outstanding. So nearly ½ of Elliott's beneficial ownership of Cabela is in the form of derivatives.
- 7. Material to be Filed as Exhibits.** Sometimes this section includes the activists letter to management detailing its perceived shortcomings and the activist's ideas for unlocking shareholder value. Also, a list of transactions detailing the accumulation of the target company shares is usually included. In the Cabelas 13D, we can see that Singer was accumulating CAB shares in the mid to low 40's up until October 22, when the price drop allowed for aggressive buying in the mid 30's.

Watch for a 13D/A to disclose an activist's exit from a target stock.

While an initial 13D is filed within 10 days of an activist crossing the 5% threshold, subsequent buying or selling must be reported on Schedule 13D/A. This filing is an amendment to the most recently filed 13D. If a 13D filer subsequently adds to or reduces a position, it must file a 13D/A to disclose the change. Elliott filed two separate 13D/A's in February of 2016, disclosing it raised its stake fractionally in Cabelas.

On October 3 of 2016 Cabelas agreed to be bought by Bass Pro Shops for \$65.50 per share in a \$5.5 billion deal. CAB stock rose 19% overnight. In was a big victory for Singer some 11 months after Elliott's initial 13D filing. Capital One Financial also agreed to buy Cabelas' credit card business for an undisclosed amount.

Just as he aggressively increased his Cabelas stake on extreme weakness in the stock, Singer took advantage of the surge in CAB shares on heavy volume to unload his position. On October 3 and 4th Elliott Associates sold 4,468,480 shares of Cabela around \$63. The [13D/A filed that day](#) showed that Elliott had dropped below the 5% threshold, its stake reduced from 11.1% to about 4.2%. Interestingly, Elliott continued to hold the derivative positions as of that filing. However when Elliott Associates filed its regular 13F for the 4th quarter of 2016 (A 13F is a quarterly SEC filing that lists the holdings of all large money managers.), there were no Cabellas shares listed in Elliott's portfolio.

It's possible that Paul Singer smiled a couple times as he closed the books on Elliott's highly successful Cabela campaign. Investors who bought Cabela stock alongside the activist and held until the 13D/A showed Elliott's selling would have pocketed 84% in less than a year. But Singer probably didn't take time for a victory cigar – he was likely too preoccupied managing the multiple activist campaigns Elliott is continually immersed in. No doubt he was also stalking his next target. This is how a manager who has annually compounded returns at 13.5% net for 40 years operates.

Indeed, on January 12 of 2017 Elliott filed an initial 13D on a fresh target: The Advisory Board Company (Nasdaq: ABCO). As of this writing, the stock is up about 50% from Elliott's initial buy levels listed in the [ABCO 13D](#).

In Part 4 of our [10-part series on Activist Investing](#), we'll examine the feasibility of cloning the activist campaigns of top activists. Investing alongside activists like Elliott Management has been very profitable – we'll discuss the pros and cons of creating a portfolio that seeks to profit off activists and the most successful activist campaigns.

PART FOUR

Here's how to zero-in on the alpha hidden in 13D activist filings.

The 13D filing marks the beginning of the activist campaign, when an activist manager goes public with plans to enrich shareholders by closing the gap between an underperforming stock and the intrinsic value of the target company.

As we discussed in [the previous chapter](#), when an individual or fund with activist intentions crosses above 5% ownership of company, the activist must file a SC 13D with the SEC disclosing details about his or her intentions. The 13D must be filed within 10 days of an activist passing the 5% threshold.

There's no doubt that investing in the target stocks of 13Ds can be very lucrative -- it you know what to look for. Not even halfway through 2017 there are some eye-popping returns from piggybacking on activist's 13D filings.

Top performing 13D targeted stocks in 2017 through 6-20.

Type	Filer	Stock	Date Filed	Stake in Company	Next Close after 13D Filing	6-20-17 Price	% Return since 13D
SC 13D	GAMCO INVESTORS	GSOL	3/27/17	5.01%	8.15	20.05	146.01%
SC 13D	DISCOVERY GROUP	FMI	1/30/17	5.20%	19.55	40.50	107.16%
SC 13D	LEGION PARTNERS	BANC	1/24/17	6.30%	15.51	21.60	39.26%
SC 13D	Engaged Capital LLC	RCII	1/30/17	9.90%	8.48	11.53	35.97%
SC 13D	RED OAK PARTNERS,	EDUC	4/12/17	7.15%	7.90	10.30	30.38%
SC 13D	VA PARTNERS I, LLC	BIVV	2/17/17	7.10%	47.45	61.31	29.21%
SC 13D	MARCATO CAPITAL	DECK	2/8/17	6.00%	52.28	66.27	26.76%
SC 13D	JANA PARTNERS LLC	WFM	4/10/17	8.30%	34.17	42.93	25.64%
SC 13D	ELLIOTT ASSOCIATES	ABCO	1/12/17	2.50%	42.00	51.40	22.38%
SC 13D	VA PARTNERS I, LLC	VRX	3/16/17	5.20%	11.03	13.24	20.04%

Source: WhaleWisdom.com and ValueWalk

But the problem with 13D-related filings is that there's an endless stream of them. Through the first five months of 2017, over 2000 activists filed 13D-related disclosures. Faced with so much information, an investor looking to extract alpha from new activist 13Ds must zero-in on only the most predictive filings.

A first step is to disregard 13D/A filings. While these amendments to initial 13Ds can have important information, 13D/As don't disclose initial activist positions. About 1500 of the 2000 year-to-date filings have been 13D/As. The rest were initial 13Ds, where an activist first disclosed owning more than 5% of a target company. Here is where we want to focus.

Still, 500 filings – or about 5 initial 13D filings per trading day – are too many to deal with. And the great majority of these filings are irrelevant. We seek the activist equivalent of pit bulls -- hedge fund aggressors who sink their teeth into management and don't let go until the target stock price is much higher.

As we saw in the previous chapter, Item 4 of a 13D requires the filer to disclose the purpose of the transaction. The 13D filers we want to follow will have one or more of the following objectives stated in Item 4: **board control, board representation, maximizing shareholder value, removing officer(s)/director(s), or a public short/bear raid (we'll discuss shortselling activists in a future installment.)**

According to FactSet, “high impact activism” whereby the activist lists one of the above as the reason for its purchase, accounted for 319 campaigns in 2016 -- about a quarter of initial 13Ds filed during the year.

We seek the activist equivalents of pit bulls -- hedge fund aggressors who sink their teeth into management and don't let go until the target stock price is much higher.

But of course, words are cheap. If writing “maximize shareholder value” on a 13D was all it took to be an activist, then every fund manager would be Carl Icahn.

ACTIVISTS/ 13D FILERS	13D's since 2015	13F \$ AUM 3-31-17
ICAHN CARL C	9	19,937,172,000
GAMCO INVESTORS	51	15,789,617,000
ELLIOTT ASSOCIATES	19	13,288,792,000
VALUEACT CAPITAL	13	11,944,486,000
THIRD POINT LLC	1	10,248,073,000
FARALLON CAPITAL	4	9,114,654,000
ORBIMED ADVISORS	12	8,822,204,000
BAUPOST GROUP LLC	3	8,493,011,000
CARLSON CAPITAL L P	5	7,864,837,000
GREENLIGHT CAPITAL	2	7,194,917,000
PERSHING SQUARE	3	5,960,734,000
JANA PARTNERS LLC	6	5,379,994,000
BLUEMOUNTAIN	5	4,942,602,000
SIT INVESTMENT ASSOC	5	4,010,218,000
CORVEX MANAGEMENT	3	3,604,924,000
STARBOARD VALUE	11	3,264,945,000
QVT FINANCIAL LP	3	3,219,915,000
SACHEM HEAD CAP	1	3,086,195,000
BLUE HARBOUR GR	2	2,775,565,000
LUXOR CAPITAL GROUP	1	2,054,839,000
KARPUS MANAGE	14	1,934,918,000
CLINTON GROUP INC	2	1,720,992,810
ANCORA ADVISORS	4	1,476,850,000
H PARTNERS MANAGE	1	1,171,010,000
RAGING CAPITAL	10	972,735,000
MARCATO CAPITAL	4	913,033,000
SANDELL ASSET MAN	2	421,854,000
BULLDOG INVESTORS	24	388,497,000
FRONTFOUR CAPITAL	3	376,846,000
RED MOUNTAIN CAP	2	338,240,000
ENGAGED CAPITAL	5	323,965,000
DISCOVERY GROUP	15	299,842,000
SARISSA CAPITAL	4	253,055,000
LEGION PARTNERS	6	182,688,000
STANDARD GENERAL	2	175,740,000
SEIDMAN LAWRENCE	7	150,502,000
WEST FACE CAPITAL	1	131,303,000
VIEX CAPITAL	11	128,278,000
NORTHERN RIGHT CA	2	80,682,000

To run a successful activist campaign, a manager must be well-financed, tough and media savvy. He or she must also be a great value investor. It's pointless to agitate for closing the valuation gap of a target company if the company turns out to be overvalued.

And crucially, an investor copying the moves of an activist will want to follow a manager who has a successful track record of profitable campaigns. It's kind of like choosing a surgeon – any old doctor can operate, but you'd personally prefer one that hasn't killed many patients.

The largest hedge funds primarily focused on activism have benefitted from a virtuous cycle -- the more money they make for investors, the more assets under management they accumulate. And the greater their AUM, the more activist campaigns they wage, and the more clout they wield.

To the left is a list of activist managers that have conducted at least one campaign since 2015. It's by no means all-encompassing – I recommend you put together your own. Services like WhaleWisdom allow investors to track managers of interest and receive alerts of filings.

But a word of warning when investing in the target stock of a new 13D: You are “buying high.”

The price of an activist targeted stock typically spikes immediately after the 13D is filed. Depending on many factors, including the notoriety of the activist and market conditions, a target stock can close 5% or more higher the day after the initial 5%+ stake is disclosed.

And the post-filing bump is on top of pre-filing price gains. Whatever the reason – the activist's buying driving shares higher, or

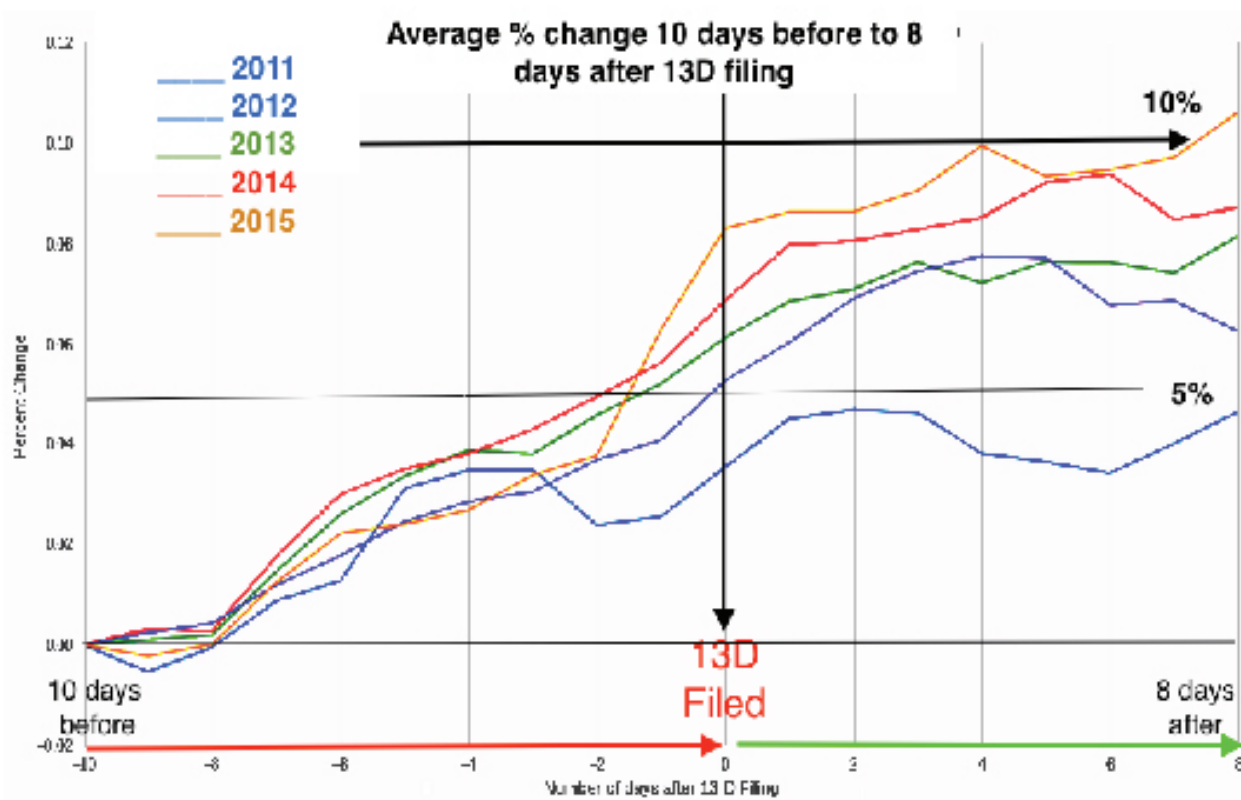
Source: WhaleWisdom.com

insiders catching word of the upcoming filing, or a combination of factors – target stocks typically rise in the days before a 13D activist filing.

Some target stocks will gap higher after the 13D event and not look back, climbing steadily in the days and weeks following. But that's the exception.

Most commonly, target stocks are volatile post-13D, and have a tendency to retrace much of their recent appreciation.

The chart below shows that in the ten days before a 13D filing, the average target stock has already moved 3% to 8% higher.



Source: Quantopian and EventVestor

Then post 13D, the typical target stock continues its ascent over the very near term, though not by as much. Of course, most activist investors – like most activists – have a long-term perspective.

The point is that, over the short term, reacting to a 13D filing can mean buying a stock that is up 5%, 10% or more over the preceding couple weeks.

Mean reversion is like gravity to quickly rising stock prices – only the most explosive stocks defy it. Losing a quick 5% by chasing a surging stock can be bad for morale.

So while each 13D event is unique, generally the best tactic when buying after a new activist filing is to accumulate one's position in the hours and days following the event.

Of course, the purchase of a 13D targeted stock is only one aspect of running a strategy that profits from activism. There is position sizing to consider. How many activist stocks should I own? Risk management is a key subject. When do I stop a loser? Then there's another crucial decision – When do I sell?

Next we'll analyze which activist investors are the very best to follow.

PART FIVE

Today's Top Performing Activist Managers Share Traits With Benjamin Graham, the First Activist Investor

Benjamin Graham is often thought of as a studious, professorial fellow who spent his days poring over documents and analyzing public companies in search of bargains.

But as we saw in chapter one of our series on Activist Investing, Benjamin Graham, the Father of Value Investing, was also the First Activist Investor – a great securities analyst who also excelled at confronting management in boardrooms and at shareholder meetings.

In 1926 Graham discovered that Northern Pipeline Corp. -- an obscure, illiquid spin-off from Standard Oil a decade earlier -- held \$95 in liquid railroad bonds yet traded at just \$65 per share.

Graham could have bought Northern Pipeline shares for his fund then bided his time until the market valued the company at its true value. But he had a realization: Northern Pipeline management could quickly and easily close the valuation gap by paying the excess assets to shareholders via a dividend. It was the shareholders “pot of gold” after all -- not management's.

But of course management saw it differently. So over the next two years, via relentless negotiation and agitation, including two proxy contests, Graham successfully compelled Northern Pipeline management to distribute its big surplus of capital to shareholders.

In “the Northern Pipeline Affair” Benjamin Graham established the template for activism: A manager finds a company trading well below intrinsic value, accumulates a sizeable stake, but rather than patiently waiting for an unknown catalyst to close the valuation gap, the manager becomes the catalyst.

Modern day managers have been using Graham's activist playbook for many years now, and the number of activist campaigns are growing worldwide. According to [Activist Insight](#), 485 companies were subjected to demands by activists through the first six months of 2017. For the full year of 2016, there were 758 announced campaigns.

But as we discussed in part two, most of these shareholder activist campaigns generate uninspiring profits for the managers and their followers, performance no better than the broadstock market. To realize major profits from following activist managers, investors must zero in on the short list of activist managers that -- like Ben Graham -- excel as both value investors and shareholder activists.

One simple way to invest alongside the campaigns of leading activists is via the 13D Activist Fund (DDDAX). It's the only mutual fund focused exclusively on following activist managers. With about \$290 million under management, DDDAX invests in 20 to 40 activist situations which fund management believes to offer the greatest profit potential.

According to the fund's website, since its inception in 2012, the 13D Activist Fund has returned 15.73% annually through 6-30-2017. That compares with the S&P 500's annualized return of 14.72% over the same period. Including the fund's sales charge, performance is 14.49%. So essentially DDDAX returns have tracked the S&P 500 since

2012. Which isn't bad considering the great majority of actively managed funds and ETFs have underperformed the market in recent years.

According to 13D Activist's fact sheet, the fund is "designed to potentially outperform market indices by generating returns that are not correlated to the broader market." Indeed, that would seem to be the attraction of an event-driven investment -- it's not dependent on a broad market uptrend to succeed. However, since inception, the fund's correlation with the S&P has been high -- 0.81 based on monthly returns. Volatility has been about 25% higher than the SPDR S&P 500 ETF (SPY).

Correlation Analysis					
Start Date	2/1/12				
End Date	7/31/17				
Correlation Basis	Monthly Returns				
Name	Ticker	DDDA X	SPY	Annualized Return	Monthly Standard Deviation
13D Activist Fund Class A	DDDAX	-	0.80	14.63%	3.56%
SPDR S&P 500	SPY	0.80	-	14.48%	2.85%

Source: Portfolio Visualizer

The 13D Fund mimics the investments of the 10 or 12 most prominent and largest managers -- Elliott Associates, Carl Icahn, ValueAct, Jana Partners, etc. It's hard to argue with this approach, as these managers have built solid track records and reputations over the years.

However, there were over 1400 initial 13D filings in 2016, submitted by hundreds of entities -- one wonders what an investor might be missing by focusing on just a dozen or so of the largest managers.

In fact, the list of the top performing activist funds includes only a few of the most famous activist managers. Below are the top ten activist funds, according to Activist Insight, based on follower returns per campaign. Only managers with at least five public campaigns since 2010 are included.

Note that many of these funds also employ passive investing strategies, along with short-selling strategies, but the returns below are for their publicly disclosed long-only activist campaigns.

Activist	Average Follower Return %	Public Campaigns Count
PL Capital	117.87	12
JCP Investment	111.58	7
Raging Capital	99.33	11
West Face Capital	76.13	6
Nicholas Swenson (Groveland Capital)	74.91	5
Coliseum Capital	74.04	7
Stilwell Value	72.23	25
Northern Right Capital	69.75	10
Laxey Partners	67.78	5
Heng Ren Investments	65.66	5

Source: Activist Insight

Here are the top performing activist investors based on the average annual return followers of their campaigns would have enjoyed. Only activists with 12 or more campaigns since 2010 are included

Activist	Average Follower Return Annualized (%)	Average Follower Return (%)	Public Campaign Count
	(%)		
Cannell Capital	53.56	36.67	12
Amber Capital	43.12	39.56	12
Clinton Group	36.05	13.87	21
City of London Investment Group	34.9	36.2	12
Relational Investors	33.11	33.43	15
Starboard Value	29.11	34.24	44
Marcato Capital Management	28.14	30.44	16
PL Capital	27.23	122.91	12
Carl Icahn	23.79	62.45	31

Source: Activist Insight

Follower returns are the returns an investor could have generated by following an activist into a stock when the activist position was announced, either by 13D filing or media announcement. The next closing price after an entry event is used in the calculation. A campaign exit is the next close after the activist fund discloses its exit from the position.

One thing is evident from studying these lists: The top performing activists tend to focus on small cap stocks. The famous shareholder activists are targeting ever larger companies as their success attracts ever more capital. The average market cap of a company targeted by Elliott Associates last year was \$26.6 billion. For Carl Icahn, it was \$26.3 billion.

Meanwhile the top activist managers -- based solely on performance -- typically target much smaller companies, generally small caps with market values under \$2 billion, and even micro caps, with market values under \$500 million.

What might explain the superior performance of small cap focused activist investors?

First of all, there are simply many more opportunities in small caps. According to S&P Capital IQ, there are about 11,500 stocks in the U.S. and Canada with market caps under \$2 billion. Only about 1800 have valuations over \$2 billion. Among primary and partial focus activists, the sub-\$2 billion market cap arena accounted for 78% of all targets in 2016, up from 72% in 2015 and 70% in 2014, according to Activist Insight.

In the first half of 2017, one-third of U.S. companies publicly targeted by activist investors had a market capitalization of above \$10 billion, demonstrating increasing focus on large cap targets among activist investors.

But while big stocks are more liquid, smaller stocks tend to be less efficiently priced. A company followed by one or two analysts, with minimal institutional sponsorship and negligible media coverage is more likely to trade below intrinsic value. Benjamin Graham's campaign that launched the activist investor category in 1926 focused on an ignored, illiquid stock.

Very often, large hedge funds shun small and micro-cap stocks for fear of displaying an illiquid portfolio. Many hedge fund investors view funds with small, more thinly traded holdings as riskier than funds holding large caps. Some studies suggest however that because professional investors herd toward actively-traded securities, illiquid stocks generally outperform their more heavily traded brethren.

Small companies may also have poor corporate governance practices compared to larger firms. While big public companies can afford boards comprised of leading executives and can consult top governance professionals, small public companies with minimal budgets typically have no such opportunities. Small cap firms may be less informed about the potential of shareholder activism than their large cap peers and thus are more vulnerable.

While corporate governance may be lacking at many small cap companies, it's likely no worse than during Graham's time. In the 1920's the balance of power at public companies was heavily skewed toward management. When Benjamin Graham approached the Northern Pipeline Co. about giving shareholders their just due, he was met with hostility. After an initial meeting, management told him: "If you don't approve of our policies, may we suggest that you do what sound investors do under such circumstances, and sell your shares."

Like Benjamin Graham, the first activist investor, today's activists have no easy task as they seek to close the gap between share price and intrinsic value, and deliver to shareholders the pot of gold that's rightfully theirs.

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