

Executive Insight >> Thought Leaders

Understanding Activist Hedge Funds

Perspectives from an industry insider

Although no one really knows for sure, it is estimated that there are over 10,000 hedge funds now managing close to \$2.0 trillion in assets.

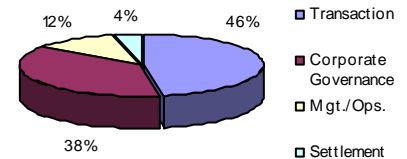
Fueled by investment flexibility, little SEC oversight, diversified returns not correlated with market movements and enormous amounts of capital continuing to flow their way, hedge funds are increasingly a major force in today's equity and debt markets and, as a result, continue to create anxiety in boardrooms throughout the world.

Not surprisingly, chief among board concerns are the powerful, demanding and relentless activist hedge fund. These are the funds loaded with cash, often hunting in packs and using aggressive tactics such as proxy contests to drive out the leadership in targeted underperforming companies. Even in today's shaky credit markets - and maybe even now more than ever, activist hedge funds are seeking to use their power to demand instant rewards and fundamental changes in corporate policy.

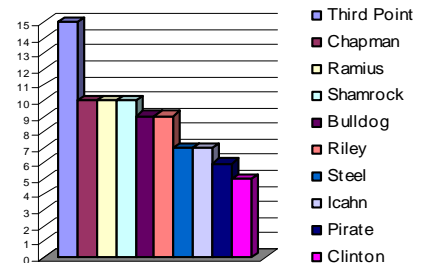
Activist Investing-Related Activity: January - September 2007			
Companies Approached by Activist Investors: 333			
Activist-Related Events: 627			
Activist Investors: 209			
Demands Made by Activist Investors			
<u>Transaction</u>	<u>Events</u>	<u>Corporate Governance</u>	<u>Events</u>
Review Strategic Alternatives (including a spinoff or sale)	157	Board Membership	172
Share Repurchase	34	Remove Board Member	26
Distribute Special Dividend	16	Remove Poison Pill	11
Open a Close-Ended Fund	8	De-classify Board Structure	14
Block a Transaction	81	Separate Chairman and CEO	4
Total Transaction	296	Adj. Special Mtg. Threshold	9
		Total Corporate Governance	236
<u>Management/Operations</u>		<u>Settlement-Related</u>	
Change in Management	34	Standstill Agreement	22
Misaligned Cost Structure	25	Total Settlement	22
Excessive Compensation	14		
Total Mgt./Ops.	73		

Exhibit 1. Source: Hedge Fund Solutions

Activist Investor Demands



Top 10 Activist Investors - 2007



Since the beginning of this year, over 200 activist investors have publicly pushed for change in 333 companies across the United States in a mixed bag of industries and market capitalizations. Close to 40% of the time the activists demanded modifications to the corporate governance structure of a company while more than 45% of the time they called for transaction-related events to take place (Exhibit 1). Some of these situations have generated improvements in shareholder value while others were absolutely devastating to the company, its employees, and its stock price.

So, not surprisingly, board members have begun to seek help from legal advisors, bankers, management consultants and others in an effort to understand how vulnerable their companies might be to these insurgents and contemplate preemptive measures to ward off unwanted attention.

In our experience, the best approach both to serve shareholders and to position companies for long-term strategic independence is to think and act proactively. Public companies apprehensive about the possibility of attracting disruptive shareholders misaligned with management's longer-term perspective on enhancing shareholder value should begin by studying the various types of activist investor along with their motivation and methodologies for successfully driving alpha. Following this, board of directors, alongside management and their strategic counselors, can begin to diagnose their vulnerability to unwanted attacks and plan the appropriate course ahead.

Top 10 Activist Investors During 2007		
Rank	Activist Investor	# of Companies
1	Third Point	15
2	Chapman Capital	10
3	Ramius Capital	10
4	Shamrock Activist Fund	10
5	Bulldog Investors	9
6	Riley Investment	9
7	Steel Partners	7
8	Carl Icahn	7
9	Pirate Capital	6
10	Clinton Group	5

Source: Hedge Fund Solutions, LLC

Categorizing the Agitators

On one end of the spectrum are the *Constructive Activists*. This type of investor is rarely found on the front page of the Wall Street Journal or highlighted in the gossip section of the NY Post. In fact, these investors prefer to fly-below-the-radar, working with boards and management teams to help unlock dormant value while preserving longer-term strategic initiatives for growth. Although a Constructive

Activist may indeed see value in a business spin-off or substantial share buyback program, it is rare to see them request board representation as a means to promoting their interest.

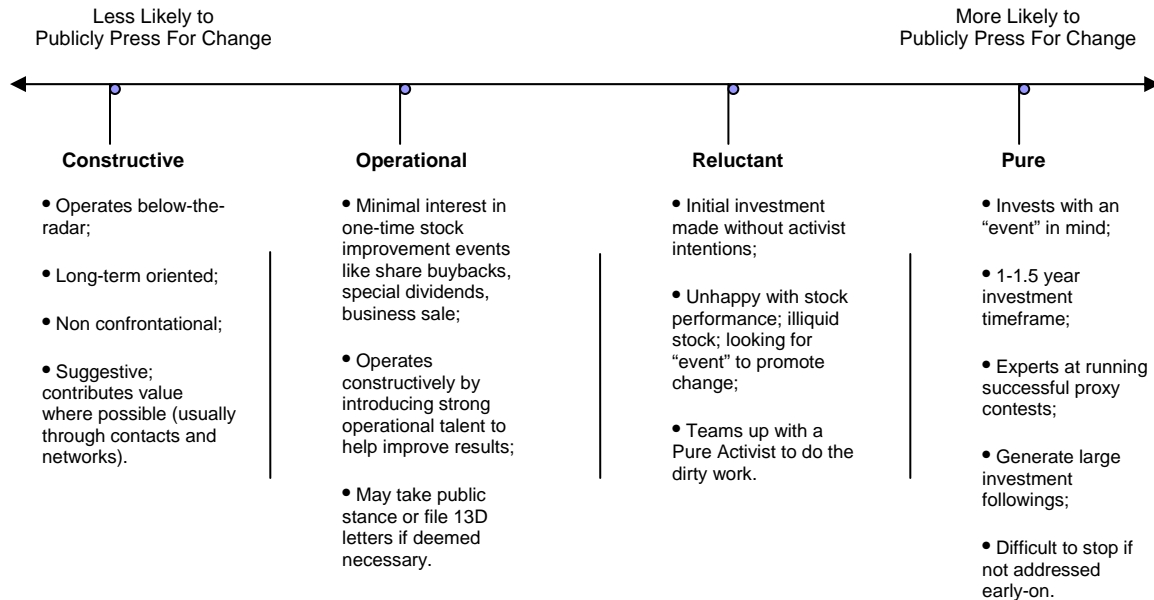
At the other end of the spectrum are the *Pure Activists*. These investors often use the public domain as a forum for attracting attention to an underperforming stock and for exerting additional pressure on the company's leadership to promote change. It is often argued that the investment philosophy of these activists is to simply plunder and move on. Running proxy contests for board representation in more than one company at a time is not difficult or uncommon for these event-driven investors.

Somewhere in-between lays two emerging classes of activist investor - the *Operational Activist* and the *Reluctant Activist*. The Operational Activist is best known for their desire and ability to introduce fair-minded and well-balanced managers into a particular investment for the purpose of enhancing shareholder value by helping improve the underlying business operations of a company. However, if the Operational Activist does not realize anticipated results in a reasonable timeframe, or believes greater value can be generated by executing different operating or financial strategies, it can be expected that board representation, management changes, and/or business divestitures will be promptly demanded.

The *Reluctant Activist* on the other hand is a fairly new breed of investor. This investor draws their ire from investment fatigue and often "informally" (read: does not file as a 13D Group with the SEC) requests the services of the Pure Activist to do the dirty work for them. Frequently, the Reluctant Activist is a large, deep value investor who has accumulated 10% to 15% of a company's stock over an extended time. Although they still maintain their fundamental investment theory is sound, they have lost confidence for any number of reasons (i.e. excessive compensation not tied to performance, implementation of unnecessary anti-takeover provisions without shareholder approval, slower than expected operational improvements, etc...). Armed with little more than the Reluctant Activist's investment hypothesis and ownership leverage, coupled with their reputation for successfully displacing board members and underperforming managers, the Pure Activist is virtually guaranteed demands will be taken seriously and changes to corporate structure will come about with the help of a little poking and prodding.

The good thing is that, despite the proliferation of these influential and regularly antagonistic investment vehicles, incumbent board members and managers can act preemptively to avoid the costly disruptions of an unwanted assault. And although understanding the activist investor and the various methods used for obtaining what they want won't be the only protective agent, it's certainly a great place to start.

Categories of Activist Investors



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This month's Executive Insight Thought Leader is provided by Damien J. Park, President and CEO of Hedge Fund Solutions LLC based in Philadelphia. Hedge Fund Solutions is comprised of former senior executives that have experienced the activist process as CEO, board directors, business managers, investor representatives, and company advisors. Since 2001 Hedge Fund Solutions has counseled funds and companies alike ranging upwards of \$25B in assets under management and \$5B in revenues on ways to effectively and efficiently enhance shareholder value through improvements in business strategy, corporate governance, internal operations, capital structure, and investor relations. Damien can be contacted at dpark@hedge-relations.com or +1 215.325.0514