

# THE WALL STREET JOURNAL.

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## ACTIVISTS WIN A SEAT AT THE TABLE

BY DAVID BENOIT

When activist investor Nelson Peltz demanded board seats at H.J. Heinz Co. in 2006, both the company and its headquarters city were indignant.

The Pittsburgh newspaper ran editorials urging support for the “hometown team.” Heinz gave employees bottles of its signature ketchup with custom labels urging them to vote against Mr. Peltz’s nominees. “We thought, ‘Gosh, we don’t need outside help,’ “ recalls Art Winkleblack, then the company’s chief financial officer.

This June, nearly a decade later, Mr. Peltz’s Trian Fund Management LP got an entirely different reception after buying a 7% stake in Pentair PLC, a Minnesota maker of pumps and valves. Pentair Chief Executive Randall Hogan spoke several times with Trian co-founder Ed Garden about corporate strategies and promptly moved to add Mr. Garden to its board.

“You never know what you don’t know,” Mr. Hogan says of his willingness to listen to the activists.

After decades of being treated as boorish gate-crashers, activist investors are infiltrating the boardrooms of large companies like never before. This year activists launched more campaigns in the U.S. — 360 through Dec. 17 — than any other year on record, according to FactSet. They secured corporate board seats in 127 of those campaigns, blowing past last year’s record of 107. Activists now manage more than \$120 billion in investor capital, double what they had just three years ago, according to researcher HFR.

The industry has come a long way since the 1980s, when Carl Icahn, Saul Steinberg, T. Boone Pickens and other mavericks would amass large stakes in companies and demand a sale of the entire company. They were called “corporate raiders” and “greenmailers” and were widely criticized.

These days activists, while not exactly welcomed in corporate boardrooms, are rarely treated as ill-mannered outsiders. “These activist funds are just a different asset class who have the same pensions and



ERIC THAYER/REUTERS

**Barry Rosenstein, top, found few investors interested in activism when he launched Jana Partners in 2001.**

endowments investing in them as other funds,” says Rob Kindler, head of mergers and acquisitions at Morgan Stanley. “The demonization of activists, when really what they are doing is providing returns to the same pension and endowment plans, just seems overdone.”

Several factors contributed to this shift, according to corporate executives, activists, bankers and lawyers. The financial crisis fanned dissatisfaction with corporate executives and brought low interest rates that helped activists thrive. Activists got more sophisticated about analyzing target companies and built alliances with other big shareholders, including mutual funds. And broad shifts in corporate governance gave more power to all shareholders, including activists.

M&A lawyer Martin Lipton, who for years has represented companies facing battles for board seats, this year called on clients to consider settling with some activists. “There is no timely way anymore for a company to be slow about responding to a decline in

performance or pursuit of the strategy,” he noted in an interview.

This year, returns for activist hedge funds averaged 3.4% through November, beating the hedge-fund average of 0.3% and the S&P 500’s 3% total return, according to industry research group HFR. Over the past five years, activist funds have returned an annual average of 8.2%, compared with the average hedge fund’s 3.2% return, HFR says.

The debate about whether activism is good for U.S. companies over the long term hasn’t gone away, most recently popping up in the presidential campaign of Hillary Clinton. She has decried “hit-and-run” activists, while also saying some activists help hold managers accountable.

Mr. Lipton has voiced similar complaints. “Much of what is wrong with America today — slow growth, widespread corporate scandals, inadequate investment in long-term projects, low wages that have not kept pace with inflation, wide swings in the economy accompanied by uncertain employment and rising inequality — is attributable to

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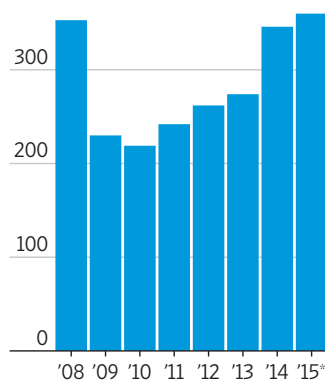
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## Activist Streak

Activist investors are infiltrating the boardrooms of large companies like never before.

### Number of activist campaigns launched in the U.S.

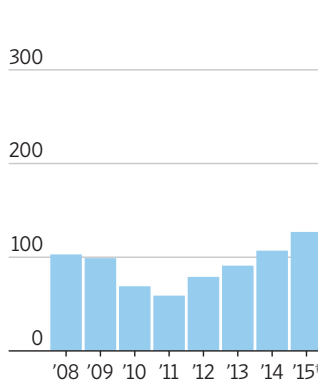
400



\*As of Dec. 17 †As of Dec. 22 Source: FactSet

### Campaigns resulting in board seats

400



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short-termism and attacks, and threats of attacks, by activist hedge funds,” he wrote recently.

Activist were a different breed back in the late 1970s and 1980s. They made “midnight raids” on stocks, building large, often controlling, stakes. Then they pushed companies to sell themselves to the highest bidder or to the raider himself, or to buy back their positions at above-market prices, a practice known as greenmail.

When Mr. Pickens bought stock in Gulf Oil Corp. in 1982, he was greeted by a lawsuit and spent months trying to get a meeting with the Chief Executive James Lee. Mr. Pickens contended the company was mismanaged, and he wanted to take control.

Other shareholders were suspicious. “One said ‘He’s a fast-buck artist,’” Mr. Pickens recalled in a recent interview. “I said, ‘Who in the hell wants to be a slow-buck artist?’”

The saga ended two years later when the company later known as Chevron Corp. swooped in to buy Gulf for \$13 billion, delivering Mr. Pickens a substantial profit.

In 1984 alone, public companies paid \$3.5 billion in greenmail, with payments above market price accounting for \$600 million, according to a study by the Securities and Exchange Commission.

Such tactics generally outraged other investors and ensured that raiders remained on the investment world’s

fringe. In 1987, the Internal Revenue Service introduced a tax of 50% on profits from greenmail, and several states passed laws making it hard for companies to buy back stakes from short-term investors at a premium.

By the 1990s, when a bull market took hold, those practices had largely faded. Targeting big companies was out of the reach for most activists because their funds remained small. And with stocks booming, there was scant investor demand for taking on prominent CEOs.

### Enron questions

The collapse of Enron Corp. and WorldCom Inc. in the early 2000s led more shareholders to question whether managers were acting in their best interests. It was around that time that today’s activists started forming funds, including what would become Starboard Value Fund and Barry Rosenstein’s Jana Partners LLC.

Mr. Rosenstein, who once worked for corporate raider Asher Edelman, launched his fund in 2001 but found few investors interested in targeting companies and agitating for change.

“One person I pitched said ‘This is not a strategy,’” Mr. Rosenstein recalls. “Nobody was doing it.”

He raised about \$20 million, opened shop with just three employees and started investing in small companies, including

Herbalife Ltd., then a lesser-known nutritional-shake maker, and York Group Inc., a casket maker.

Mr. Rosenstein and his fellow activists hoped to follow a path to respectability blazed by private-equity funds, who had largely shed their image as buyout “barbarians” and transformed themselves into respected, publicly traded institutions. To do that, activists needed to persuade others, including potential allies at mutual funds, they were interested in building value at target companies, not just making a quick buck.

It was during this period that Mr. Peltz launched his proxy fight at Heinz. When company shareholders met to elect the board, the tension was thick. Mutual fund Capital Research & Management Co., a large shareholder, voted for some Trian nominees, stunning Heinz executives and helping put Mr. Peltz and an ally on the board.

After winning the vote, Trian didn’t push a quick sale, but stayed around. Board members say Trian helped focus the company on cutting certain costs and increased spending on marketing, and sped up the company’s timetable for moves that improved profit margins.

“They didn’t come in with a sledgehammer saying you have to do it this way,” says Mr. Winkleblack, then CFO.

“It was so seminal because it was a huge company to go after at that time,” says Chris Young, an activism-defense banker at Credit Suisse Group AG. “It was operational in nature, and you got mainstream, long-only investor support. That, I think, started opening people’s minds to the art of the possible.”

In 2013, Heinz was sold to Brazilian private-equity firm 3G Capital Partners LP and Warren Buffett’s Berkshire Hathaway Inc. William Johnson, then Heinz’s CEO, now is an adviser to Trian, and Mr. Winkleblack was a Trian board nominee at DuPont Co.

The financial crisis that began in 2008 was a setback for many activists, who saw their funds lose billions. But ultimately it created fertile conditions for the current activism boom.

In the wake of the crisis, many corporate executives took a more-conservative approach, not wanting to be seen as risk-

takers. They hoarded cash and avoided big spending. When interest rates dropped, they borrowed money not for expansion, but to buy back stock and increase dividends — exactly what some activists were pushing for. Critics of such moves say companies would be better off using capital on long-term investments such as infrastructure, research and employees, but activists say managers have proven poor spenders and shareholders can handle the money better.

At the same time, changes in corporate governance were making it easier for activists to win board seats. Between 2011 to 2014, a group at Harvard University led by professor Lucian Bebchuk campaigned to get more than 100 major companies to put their entire boards up for annual election, instead of staggering directors in multi-year terms.

Annual elections give activists leverage because boards can be overturned in one fell swoop rather than over a series of years. In 2000, 300 of the S&P 500 companies had staggered boards. This year, only 49 do.

Perhaps the most important change, according to both activists and their detractors, is that activists got more sophisticated about analyzing how to improve operations at target companies. They recruited executives with experience in the relevant industries to work alongside them on campaigns.

In 2012, for example, William Ackman’s Pershing Square Capital Management LP launched a proxy fight against Canadian Pacific Railway Ltd. When Pershing Square called the former boss of rival Canadian National Railway Co., Hunter Harrison, for advice, it found a willing partner. Pershing Square campaigned with Mr. Harrison as its CEO candidate, eventually winning seven board seats and putting Mr. Harrison in charge.

### Company plans

Mr. Rosenstein’s Jana Partners, which now employs more than 50 and runs more than \$10 billion in assets, typically presents companies with several-step plans about how they can cut costs, restructure their balance sheets, shed assets and change strategy.

Last year, drugstore chain

Walgreen Co. agreed to put Mr. Rosenstein on its board and gave him a say in two other seats, all without a threat of a public fight and a stake of only 1%.

Similarly, in 2013, Microsoft Corp. said it would add a ValueAct Capital Management LP partner to its board, even though ValueAct held a stake of just 1%. Behind the scenes, ValueAct had support from some of Microsoft's biggest shareholders, including Franklin Templeton Investments and Capital Research.

Trihan has gained board seats, without a fight, at companies

ranging from fast-food chain Wendy's Co. to Bank of New York Mellon Corp. This year, it took a stake in food distributor Sysco Corp. and was given two seats only a week after meeting management.

"They aren't on a search-and-destroy mission," says Wesley von Schack, the lead director of Bank of New York Mellon. "They come in and speak to the right issues."

Activist thinking now appears to be influencing even executives who haven't been targeted. Executives now routinely talk about the return on every dollar spent — a frequent focus

of activists. Chief executives appointed this year by McDonald's Corp. and United Technologies Corp. have called themselves internal activists.

"We're the activists at UTC," United Technologies CEO Gregory Hayes said in October. "If an activist wants to come in and make a suggestion that we do it, we can say, 'Been there, done that.'"

General Electric Co. Chief Executive Jeffrey Immelt has gone so far as to invite one activist to get involved in his company.

When GE announced in April that it would shed GE Capital,

its finance arm, Mr. Peltz, who wasn't an investor, called to congratulate Mr. Immelt.

"I'd love to have you in the stock," Mr. Immelt told Mr. Peltz.

As Trihan did due diligence, it urged Mr. Immelt and his team to eliminate more of GE Capital than planned and to tap the debt markets for buybacks. GE executives felt the activist was in the right ballpark. Trihan invested \$2.5 billion, its biggest investment ever.

A month after the stake was disclosed, GE's stock crossed \$30 a share for the first time since the financial crisis.