DISCOVERING VALUE WHITNEY TILSON JOHN HEINS

It Pays to Be Pushy

When it comes to shareholder activism, the battle lines have been drawn. On one side are investors who refuse to stand idly by when they believe companies in which they own shares are being mismanaged. As Jonathon Jacobson, of Highfields Capital Management, a well-regarded Boston hedge-fund manager, puts it: "Poor management is able to persist because shareholders aren't willing to do anything about it. That inaction is an abdication of responsible ownership and fiduciary duty."

On the other side are executives and directors, who often consider investors who agitate for change to be nothing but fast-buck artists. In a memo to clients that was widely circulated a few years ago, Wachtell, Lipton, Rosen & Katz, a New York City law firm that often represents corporate boards against activist shareholders, described its typical defense: "Expose the attackers for what they are: self-seeking, short-term speculators looking for a quick profit."

Our view. Investors do occasionally undertake ill-advised efforts to promote change, causing unneeded distraction at the companies they target. But we believe unequivocally that vocal and aggressive investors play a critical role in holding management teams accountable. In an ideal world, top executives would make key decisions as if the money were their own. When they don't act responsibly, shareholders—whose money it actually is—should stand up and be heard.

What difference can smart activist investors make? In 2007, Jeffrey Ubben's ValueAct Capital bought a large stake in Valeant Pharmaceuticals International (symbol VRX), attracted by the company's diverse portfolio of over-the-counter drugs, and prescription drugs that faced few risks from patent expirations. He came to believe, however, that the company was spending too much on research and development and that it operated in markets in which it was a weak competitor. When executives were unresponsive to his suggestions, Ubben helped force a CEO change. In short order, Valeant sold its Western European operations, cut R&D spending and enlisted partners to help it pay for new drug development.

The new business model generated much more free cash flow, so Valeant started buying related businesses in emerging markets, such as Poland and Brazil. Last June, Valeant landed a bigger fish, merging with drug maker Biovail to create a company that generates about $2 billion in annual revenues and roughly $700 million in free cash flow (the amount of cash profits left for dividends, share buybacks and acquisitions).

> **"Vocal and aggressive investors play a critical role in holding management teams accountable."**

From the end of 2007 through mid March, Valeant's shares tripled, to $39.

In a recent interview with *Value Investor Insight,* the newsletter we publish, Ubben laid out bullish cases for several other stocks: insurance broker Willis Group (WSH), Internet service company VeriSign (VRSN) and medical-products maker C.R. Bard (BCR). Among his firm's more recent investments, according to government filings, are The New York Times Co. (NYT) and bond insurer Moody's (MCO).

We recently bought **J.C. PENNEY (JCP)**—in part because Pershing Square Capital Management, another noted activist, accumulated a large position in the stock. In January, Penney announced that Pershing Square's Bill Ackman and a sometime collaborator, Steven Roth, chairman of Vornado Realty Trust, would join the company's board. Given Penney's potential to boost its profit margins (which trail those of its peers) and unlock value in its vast real estate holdings, we expect the involvement of Ackman and Roth to benefit shareholders. The stock, at $37, is up 15% so far this year, but we see opportunity for more gains. With improved operations, better management of real estate assets and share buybacks, the stock, we believe, could reach $50 to $60 within two years. ■

COLUMNISTS WHITNEY TILSON AND JOHN HEINS CO-EDIT *VALUE INVESTOR INSIGHT* AND *SUPERINVESTOR INSIGHT.* IN ADDITION TO OWNING SHARES OF J.C. PENNEY, FUNDS MANAGED BY TILSON ARE SHORT SHARES OF MOODY'S.

PETER ROSS