Q&A with Lauren Taylor Wolfe

Managing Director and Investing Partner, Blue Harbour Group

IN CONVERSATION WITH HAMLIN LOVELL

Hamlin Lovell: What inspired you to become an activist investor?

Lauren Taylor Wolfe: When I approach an investment, my return can be generated from various scenarios and outcomes. The concept that I could influence or impact the likelihood of any one of those outcomes was quite appealing to me. Not all investors act like activists. But the idea that we can help influence and drive our own returns is quite attractive. It also forces us to look over the long-term and take a big picture view. We think as if we are the owners of the business working alongside the managers – this means acting in the long-term best interests of all shareholders.

HL: So what are the advantages of being a collaborative activist, as opposed to a hostile activist who might get involved with proxy contests, poison pen letters, and media campaigns?

LTW: I think it is a little bit of an over-simplification to separate activism into hostile versus non-hostile. At the end of the day, we are all trying to do the same thing, which is to drive attractive returns for our investors. At Blue Harbour our approach, which is exclusively friendly, reflects our style. We have been in business for 10 years, but we have never written a poison pen letter, we have never run a proxy contest, and we have built a substantial amount of reputational goodwill having done so. Again, we are backing these management teams and often times if we are invited on boards, or if we are investing in a new company, we can use CEOs as references and as ushers into new potential investment opportunities. For us the collaborative approach is the right approach.

HL: Why do you need most of the capital to be locked up for three years, and what are the benefits of having the pension fund CalSTRS as one of your anchor investors?

LTW: Taking a long-term view gives us unique perspective. Having long-locked capital is a key competitive advantage for Blue Harbour and it is critical to our process. We are coming up with ideas and engaging with management teams and boards, to unlock value for all shareholders. However, those ideas take time to implement. It can take a year or two years for an idea to be implemented, and then it will take time for the market to appreciate the value of the idea and reflect it in the stock price.

Another benefit of the long-locked capital is that we know the companies and the space in which we are investing, so if other peers of ours have shorter-term capital, in certain situations they might be forced sellers, while Blue Harbour can take advantage of those opportunities because we have the flexibility and duration arbitrage.

Lauren Taylor Wolfe made *The Hedge Fund Journal's* Leading 50 Women in Hedge Funds 2015 report. The report is published every two years. The 2011, 2013 and 2015 reports were sponsored by EY.

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Having CalSTRS as one of our largest partners is excellent; they are a great fit for us. They are one of the foremost thought leaders in corporate governance issues impacting American corporations today. When we walk into a boardroom or engage with management, they typically know who our LPs are, so having CalSTRS behind us adds a little bit of heft and weight to our discussions.

HL: Blue Harbour's founder, Clifton Robbins, was previously working in private equity for KKR and General Atlantic. Does that inform the Blue Harbour investment process?

LTW: Absolutely. Cliff's background in private equity informs our investment process, in that what we do is apply a private equity approach to public markets. Again, our investment lens is that we are looking for companies that are attractively valued, typically with high free cash-flow yields, or hard-asset values and strong balance sheets that give us a margin of safety on the downside. Then we are coming to the table with ideas, three or four ideas, on how the company can unlock value – just as a private equity firm would.

However the difference is that we are not levering up the company, we are not paying a premium, and we are not taking control of the company. But with our minority interests and with facts and reason, we can influence a company to unlock value and do the same three or four things that a private equity investor would have done, without paying a premium. So that certainly informs how we think about investing.

HL: How about your own prior experience, which included being a technology consultant?

LTW: My background is that earlier in my career I was a technology consultant, and after that I worked at a family office doing highly concentrated investing in small and micro-cap, public and private companies. I love the small and micro-cap space. I personally love doing a lot of due diligence, getting my hands a little bit dirty, really getting to know a company and then partnering with management teams. I enjoy the idea of getting to know a company deeply, coming up with ideas and watching those ideas get implemented to generate returns for all shareholders.

The other thing that I think is important to my approach is the value of diversity. Some people think diversity is being a woman, or certain ethnicity, but to me diversity is really about thinking differently: it is cognitive diversity. For me, it is the extent to which being a woman causes me to think differently and add value. At Blue Harbour, the team has a range of different experiences and backgrounds. And we each come to the table with a different approach to breaking down problems. My view is that this cognitive diversity, this diverse thinking, leads us to better decision-making and better solutions.

HL: That is really interesting. Do you find better opportunities in mid-caps than in large caps? If you do, then how much capital can you realistically put to work in the mid-cap space?

LTW: Throughout Blue Harbour's history we have invested in the small and mid-cap space, which includes companies with market values anywhere from $1 billion to $10 billion. We think there is tremendous amount of value there. There are thousands of companies, but we are running a very highly concentrated portfolio, so we are investing in roughly only three or four new core positions – large positions – in any one year.

These companies are also unique in that they are less travelled, so you don't have as many bankers or sell-side research analysts targeting them, and from our perspective as a friendly activist investor, we can come to the table with ideas around capital allocation that these teams might not be thinking up every single day. The management teams at small and mid-cap companies typically come up through marketing or manufacturing or operations, and have fewer resources than a large-cap company has. So they are often focused on operations and on strategy, whereas we can come to the table with strong ideas about capital allocation, capital structure and other strategic options, which enables us to add value very easily.

HL: Some US activists have started spreading their wings into Europe and Japan. Do you think you would ever go overseas for opportunities?

LTW: We have the capability to, and we certainly would consider it, depending on how attractive the opportunity is. But in general, Blue Harbour invests in North America, predominantly in US and Canadian companies. We understand the rules and the regulations here, and this is where we have been investing for many years. So the bulk of our investing will probably remain in North America.

HL: Why have activist funds in general, and yours in particular, generated such high returns? What are the extra risks that you might be getting paid for?

LTW: I think it comes back to the idea that we are driving our own returns to some extent. We are coming up with ideas and influencing management teams around how they can potentially unlock value. In theory, we should be not as correlated to the market and should be generating excess alpha through these ideas.

HL: We are now into the 7th year of the US equity bull market, is it getting harder to find undervalued firms?

LTW: I think it is undeniable that the market is more expensive than it was in 2010, 2011 and 2012. But again, Blue Harbour is looking in a sea of thousands of companies in the $1-10 billion market-cap space, and we are only looking for three or four new core investments each year. U.S. companies are sitting on record levels of cash, so there is a tremendous amount of cash on corporate balance sheets waiting to be deployed. There is also improving confidence in the boardroom. Capital is still inexpensive on a relative historical basis. We think there is going to be a ton of M&A that continues to get done, and we see new and larger M&A deals in the papers almost every day. So while it is undeniable the market is more expensive than in the past, we think that for activists who can drive returns, there is tremendous opportunity.

HL: Why was an activist approach needed to help advocate for the merger of PVH and Warnaco?

LTW: The PVH and Warnaco deal was an interesting one. First, the concept that PVH, the owner of the Calvin Klein brand, should merge with Warnaco, the largest licensee of its underwear and jeans business, was quite simple and well known. What was more complex was the timing and the valuation associated with a potential merger.

To take a step back, Blue Harbour was involved with both of these companies. We built a stake in PVH in 2009 and we were backing that management team, led by Manny Chirico, an excellent executive who unusually had the background of CFO before he was PVH's CEO, and had architected PVH's acquisition of Calvin Klein. We had backed him in his acquisition of Tommy Hilfiger, a transaction that made PVH much larger, gave it a platform in Europe, and – because the Calvin Klein and Tommy Hilfiger brands were growing rapidly – it caused PVH's stock multiple to expand.

If you fast forward to 2011, Warnaco was operating two very sizeable jeans and underwear businesses, and had done a great job building its presence in Europe and in emerging markets. But because they had a lot of exposure to Southern Europe during the 2011 European debt crisis and the subsequent weakening economies, Warnaco's shares fell substantially over a short period.

That is when Blue Harbour got involved, because we realized it was an opportune time for the two entities to come together. In the past, PVH and Warnaco had flip-flopped in terms of both valuation and size, but now the stars were aligning. PVH was trading at a much higher multiple, and was almost double the size of Warnaco. We saw an opportunity to engage with Warnaco, and voiced support for a combination. The value of the deal was in allowing PVH to maintain greater control over the Calvin Klein brand; but it also gave them an international platform in emerging markets, beyond their European platform to further grow their Calvin Klein and Tommy Hilfiger businesses.

So we supported PVH in the acquisition of Tommy Hilfiger, we supported Warnaco in the sale to PVH, and we think that PVH as an entity is stronger today than it has ever been.

HL: Do you ever find yourself invested in the same firms as other activists and do you have any view on why the SEC is starting to look closely at whether the activists are acting in concert?

LTW: All of Blue Harbour's investments are internally sourced, they are all the result of our own proprietary due diligence. At times other investors might see value where Blue Harbour sees value, but that is what it is.

In terms of the SEC, they play a critical role into our capital system and in protecting investors. They do a great job of that and Blue Harbour is a beneficiary of being able to invest in well-regulated markets.

HL: Could activists eventually become victims of their own success? If activism drives up standards of corporate governance so that all companies are focused on shareholder value, will there be anything left for the activists to do?

LTW: To the contrary. I actually think that the improved corporate governance landscape has significantly enhanced shareholder communication and engagement by boards and management teams.

At Blue Harbour, our first idea is never around corporate governance. We generally think that good corporate governance is important, and the types of management teams we back, who are inclined to take actions to catalyse returns, are the same teams that appreciate the value of good corporate governance. But when Blue Harbour walks in, our ideas on value are usually around capital structure or strategy, and not primarily corporate governance. At the end of the day, good governance I think is good for all investors and we are really just a beneficiary of the improved governance landscape. **THFJ**