

# Stacey Muirhead Capital Management Presentation to:

14<sup>th</sup> Annual Value Investor Conference

Omaha, Nebraska

May 5, 2017



---

# An Underappreciated Warren Buffett Investment Technique

Event Driven Investing



Event Driven Investments

Arbitrage

Work-Outs

Risk Arbitrage

They are all the same thing.



# Event Driven Investments

---

- Pursuit of profits from announced corporate events
- Mergers, recapitalizations, spin-offs, liquidations, reorganizations, self tender offers, etc.
- Evaluation based on probability of event occurring, time, upside, downside
- We expect to profit regardless of the behaviour of the stock market in most circumstances



# Event Driven Investments

---

*“These are securities whose financial results depend on corporate action rather than supply and demand factors created by buyers and sellers of securities. In other words, they are securities with a timetable where we can predict, within reasonable error limits, when we will get how much and what might upset the applecart. Corporate events such as mergers, liquidations, reorganizations, spin-offs, etc., lead to work-outs.”*

*Buffett Partnership Letter, January 24, 1962*



# Event Driven Investments

---

*“The risk pertains not primarily to general market behavior (although that is sometimes tied in to a degree), but instead to something upsetting the applecart so that the expected development does not materialize. Such killjoys could include anti-trust or other negative government action, stockholder disapproval, withholding of tax rulings, etc. The gross profits in many workouts appear quite small.*

*[...] However, the predictability coupled with a short holding period produces quite decent annual rates of return. This category produces more steady absolute profits from year to year than generals do. In years of market decline, it piles up a big edge for us; during dull markets, it is a drag on performance.”*

*Buffett Partnership Letter, January 18, 1964*



# Event Driven Investments

---

*“In past reports we have told you that our insurance subsidiaries sometimes engage in arbitrage as an alternative to holding short-term cash equivalents. We prefer, of course, to make major long-term commitments, but we often have more cash than good ideas. At such times, arbitrage sometimes promises much greater returns than Treasury Bills and, equally important, cools any temptation we may have to relax our standards for long-term investments.”*

*Berkshire Hathaway 1988 Letter to Shareholders*

7



# Event Driven Investments

---

*“Since World War I the definition of arbitrage – or “risk arbitrage,” as it is now sometimes called – has expanded to include the pursuit of profits from an announced corporate event such as sale of the company, merger, recapitalization, reorganization, liquidation, self-tender, etc. In most cases the arbitrageur expects to profit regardless of the behavior of the stock market. The major risk he usually faces instead is that the announced event won’t happen.”*

*Berkshire Hathaway 1988 Letter to Shareholders*





# Event Driven Investments

---

*“To evaluate arbitrage situations you must answer four questions: (1) How likely is it that the promised event will indeed occur? (2) How long will your money be tied up? (3) What chance is there that something still better will transpire – a competing takeover bid, for example? And (4) What will happen if the event does not take place because of anti-trust action, financing glitches, etc.?”*

*Berkshire Hathaway 1988 Letter to Shareholders*

9



# Event Driven Investments

---

## Case Study



**BERKSHIRE HATHAWAY INC.**



# Event Driven Investments

---

## Transaction Details

- Definitive agreement for Berkshire Hathaway (BRK) to acquire Precision Castparts (PCP) announced on 08/10/15
- \$235 per share in cash
- Quarterly dividends maintained until closing
- No financing condition
- HSR act approval and other foreign competition clearances required (EU, Canada, China, France, Turkey, Ukraine)
- PCP shareholder approval
- Expected closing in Q1 2016



# Event Driven Investments

---

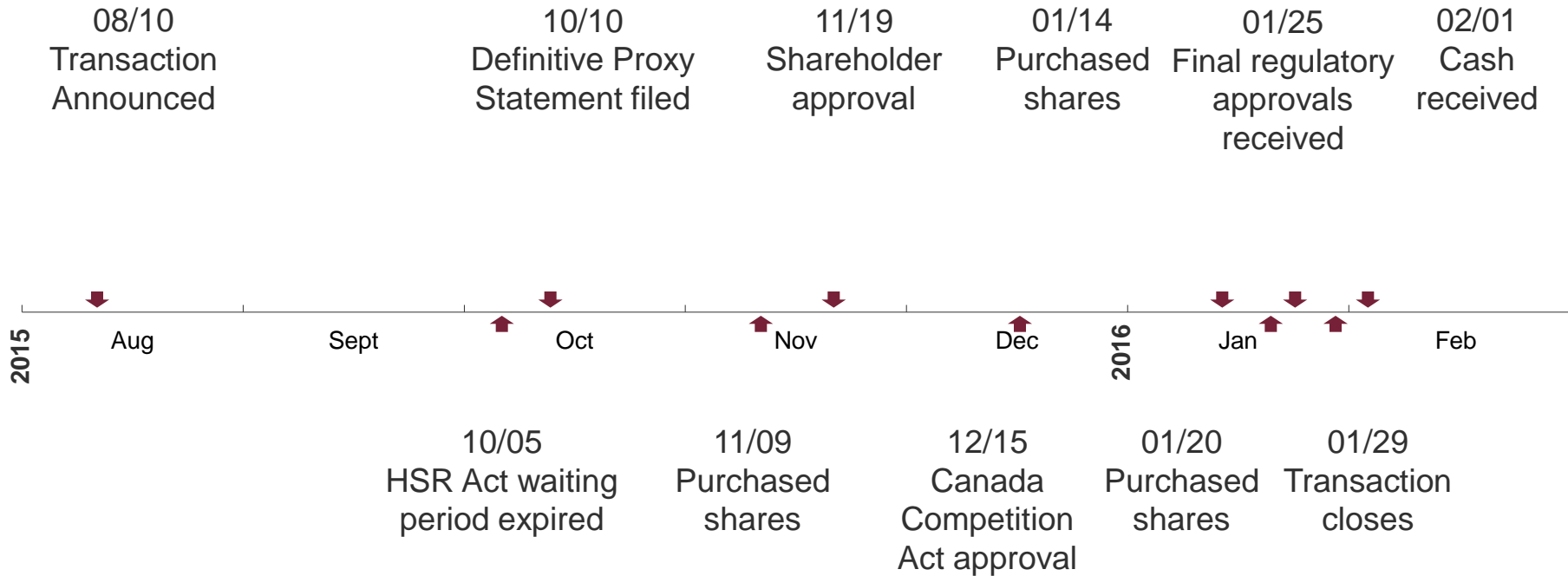
## Key Considerations

- BRK track record for closing transactions
- No financing condition
- Premium price to be received
- HSR Act approval received on 10/05/15
- Shareholder approval received on 11/19/15
- Remaining foreign competition approvals seemed routine



# Event Driven Investments

## Timeline



# Event Driven Investments

## Return Analysis (per share)

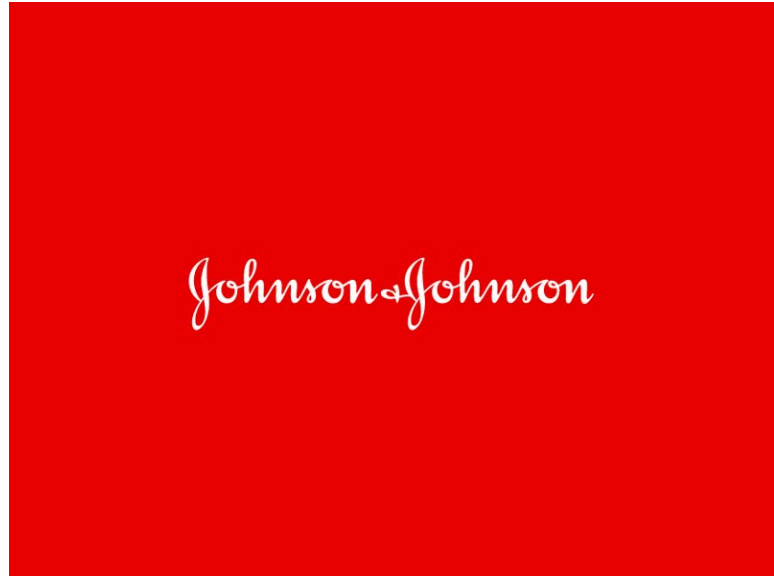
	<u>US \$</u>
Cash Received	235.00
Dividend Received	<u>0.02</u>
	235.02
Price Paid	<u>231.20</u>
Gross Profit	3.82
	1.65%
Closing Date	01/29/16
Weighted Average Holding Period	54 days
Annualized Rate of Return	<u>11.17%</u>



# Event Driven Investments

---

## Case Study



# Event Driven Investments

---

## Transaction Details

- Definitive agreement for Johnson & Johnson (JNJ) to acquire Actelion Ltd. (ATLN) announced on 01/26/17
- \$280 USD per share in cash plus one share in a new R&D company (Idorsia)
- Minimum Acceptance rate of 67% of total shares
- Competition clearances required from United States, European Commission, Japan, Russia, Israel and Turkey
- Material Adverse Event – 15% of EBIT or 10% of sales
- Expected closing in late Q2 2017 (06/15/17)





# Event Driven Investments

---

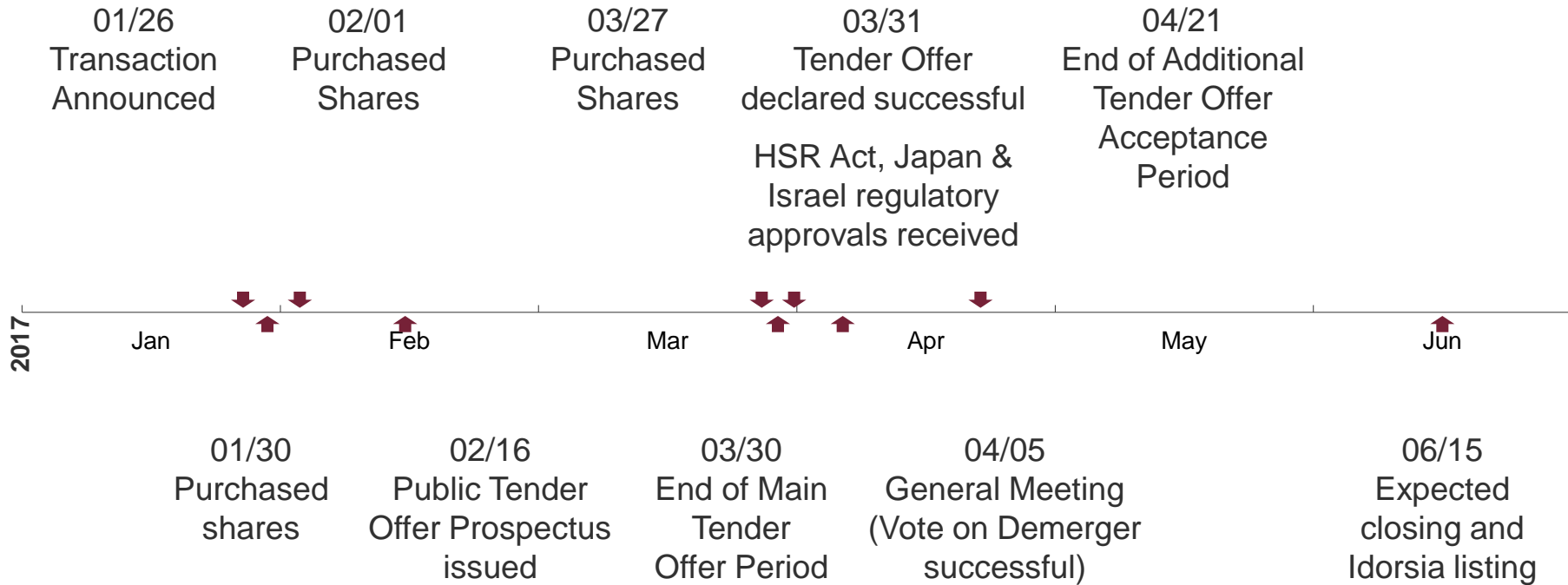
## Key Considerations

- No financing condition
- Premium price – CEO lock up agreement
- Well shopped before agreement
- Idorsia potential valuation
  - Value of early stage pipeline
  - JNJ – 16% interest @ 235 million CHF (c. 11.50 per share)
  - c. 8 CHF per share in cash
- Potential Uptravi issue - Will this trigger a Material Adverse Event?



# Event Driven Investments

## Timeline



# Event Driven Investments

## Expected Return Analysis (per share)

	<u>CHF</u>
Cash Received	280.42
Idorsia Estimated Market Price	<u>10.00</u>
	290.42
Price Paid	<u>270.99</u>
Gross Profit	19.43
	7.17%
Closing Date	06/15/17
Weighted Average Holding Period	108 days
Annualized Rate of Return	<u>24.23%</u>



# Event Driven Investments - Summary

---

## Benefits

- Returns depend on transaction completion and not on movement in equity markets
- Most transactions are uncorrelated with each other
- Short completion times lead to cash availability
- Multi-strategy benefits – adds another page to our “investment playbook”
- Good information availability – ***Read the Documents!***



# Event Driven Investments - Summary

---

## Risks

- Transactions can break for many reasons
  - Financing issues
  - Shareholder rejection
  - Regulatory concerns
  - Anti-trust approvals
  - Material Adverse Event
- Any single transaction is a binary event
- A good batting average is required



---

# Question & Answer Period

