Stacey Muirhead Capital Management Presentation to:

CAVIE
CENTER FOR THE ADVANCEMENT OF VALUE INVESTING EDUCATION

July 20, 2018

An Underappreciated Ben Graham/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 bull 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

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

Event Driven Investments

Case Study

ACTELION

Johnson & Johnson

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

01/26
Transaction Announced

02/01
Purchased Shares

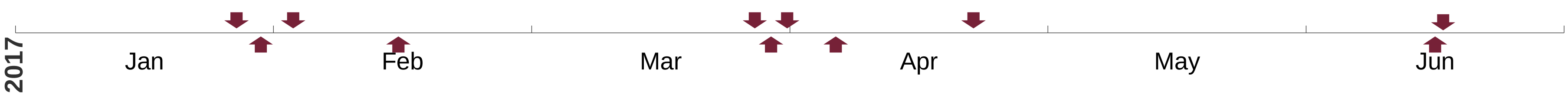
03/27
Purchased Shares

03/31
Tender Offer declared successful

HSR Act, Japan & Israel regulatory approvals received

04/21
End of Additional Tender Offer Acceptance Period

06/20
Sold Idorsia shares



01/30
Purchased shares

02/16
Public Tender Offer Prospectus issued

03/30
End of Main Tender Offer Period

04/05
General Meeting (Vote on Demerger successful)

06/19
Closing and Idorsia listing

Event Driven Investments

Return Analysis (per share)

	USD
Cash Received	280.00
Idorsia Market Price	14.92
	294.92
Price Paid	274.26
Gross Profit	20.66
	7.53%
Closing Date	06/19/17
Weighted Average Holding Period	113 days
Annualized Rate of Return	24.32%

Event Driven Investments

Case Study

Shire

Takeda

Event Driven Investments

Transaction Details

- Definitive agreement for Takeda Pharmaceuticals to acquire Shire plc announced on May 8th
- $30.33 USD per Shire share in cash and either 0.839 new Takeda shares or 1.678 Takeda American Depository shares
- Dividends to be paid until closing
- Shareholder approval required by both companies
- Expected closing in late Q2 2019 (06/24/19)

Event Driven Investments

Key Considerations

- Acquisition will create the world's 9^{th} largest pharmaceutical company
- Approximately 50% of revenues will be from the United States
- Minimal product overlap
- Takeda Shareholders may not approve transaction
- Hedging Takeda American Depository shares is difficult

Event Driven Investments

Timeline

STACEY MUIRHEAD
CAPITAL MANAGEMENT

Event Driven Investments

Expected Return Analysis (per share)

	USD
Cash Received ($30.33 x 3)	90.99
Takeda ADS consideration ($19.68 x 1.678 x 3)	99.07
Dividends	1.05
	191.11
Price Paid	160.91
Gross Profit	30.20
	18.77%
Expected Closing Date	06/24/19
Weighted Average Holding Period	377 days
Annualized Rate of Return	18.17%

Event Driven Investments - Summary

Positives

- 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

Negatives

- Transactions can break for many reasons
  - Financing issues
  - Shareholder rejection
  - Regulatory concerns and anti-trust approvals
  - Material Adverse Event
- Any single transaction is a binary event
- A good batting average is required
- Short term nature of event driven investing creates tax exposure

Question & Answer Period