

The Corvex Discount

A year ago Corvex, a hedge fund run by Keith Meister, published a detailed analysis of why ADT was a cheap security. ADT is the largest market leader in home security monitoring in North America. They were spun out from Tyco earlier in 2012. Meister identified an underleveraged balance sheet supporting a business model with highly recurring revenues well positioned to grow through accretive acquisitions of smaller players. In addition, increasing ADT's leverage and using the funds to buy back stock looked like a good way to return value to shareholders.

Corvex took a 5% position in ADT and Meister joined the board. It took a while, but by the Summer ADT seemed to have taken Meister's advice to heart since they increased their stock buybacks and in September issued \$1 billion in debt in part to fund their buyback program. But evidently Meister's view from his position on the company's board was no longer as positive as it had been in late 2012, when he assessed a Downside Case for the stock at \$43 and an Upside Case of \$63. At the time of his presentation in October 2012 it was trading at around \$38. Last Friday it closed at \$44.01.

On the weekend ADT announced that it had agreed to buy Corvex's 5% position back at Friday's closing price, and that Meister was resigning from the board. There's no way of knowing why Corvex suddenly exited its position, but in the poker game that took place between ADT's CEO Naren Gursahaney and Corvex's Keith Meister over the pricing of this trade, there's little doubt that Gursahaney's naivete was fully exposed. Clearly a sale of 10.24 million shares of ADT, particularly when combined with the resignation of a director who was up until then clearly focused on shareholder value, should have taken place at a steep concession to the closing price. Meister understood this. Gursahaney did not. The consequent 5.8% drop in ADT's stock price was in response to

this news. A more shareholder-oriented CEO, or a better negotiator, would have been less desperate to rid the board of Meister, but ADT instead destroyed at least \$26 million of value for the company by overpaying for its shares.

We owned ADT ourselves and would have at least liked the opportunity to make the same sale as Corvex with the same information, but equal treatment was not afforded to all the other shareholders. Activists are most definitely a two-edged sword in financial markets. They are by nature short term in orientation, so their claims to represent the interests of shareholders against intransigent management may not always be genuine. Some CEOs can add value to a company by resigning (such as Steve Ballmer from MSFT). In some cases, an activist investor can reduce the value of a security through its presence. Since Corvex can so quickly turn from pro-shareholder activist to opportunistic short term value extractor, the Corvex Discount might now reasonably exist on any security in which they have an interest. Just another hedge fund seeking a quick profit. He was a fiduciary to ADT's shareholders until he suddenly wasn't. His hedge fund clients might take note.