Value Investor INSIGHT
The Leading Authority on Value Investing
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Joint Ventures

"Activist" investing is all the rage today, but Cliff Robbins has successfully pursued his version of it since well before the term came into popular use.

While the "friendly activism" he practices might strike some as a contradiction in terms, Cliff Robbins has a different view. "In the smaller firms we target, the best managers don't care where good ideas come from," he says. "Bring them those ideas and there's no reason for the relationship to be adversarial."

His approach has certainly proven investor-friendly to date. Robbins' Blue Harbour Group now manages $3 billion and its flagship long/short strategy since inception in late 2004 has earned a net annualized 8.9%, vs. 5.1% for the S&P 500.

The firm's large, concentrated positions today come from a particularly diverse set of industries, including specialty retail, power-generation systems, garbage, Internet infrastructure and media. See page 2

INVESTOR INSIGHT

Clifton Robbins
Blue Harbour Group

Investment Focus: Seeks high-quality companies with identifiable but as yet latent strategic, financial or operational levers to pull that would enhance value.

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Other companies in this issue:
Allscripts, Brocade Communications, CACI International, Chico's, Conversant, Intel, Lockheed Martin, Nabors, Strayer Education

Investor Insight: Clifton Robbins

Cliff Robbins, Robb LeMasters and Todd Marcy of activist investor Blue Harbor Group describe why they don't try to fix broken businesses, what tools in their activist toolbox are most handy today, why they never take a full position right away, and what they think the market is missing in Babcock & Wilcox, Tribune, Progressive Waste and Akamai.

Successful activists are often excellent value investors who also have an agenda for management. Do you ever just pursue the value without the agenda?

Clifton Robbins: We need both. The company has to be a great investment, fundamentally undervalued and trading at a discount to what we consider to be its intrinsic value. But in addition we have to have ideas we want management to pursue over time to unlock the value.

The key is to think like an owner, literally asking of any potential investment, "If we owned the whole company, what would we do differently?" Should we sell a division whose losses are causing value elsewhere in the company to be unrecognized? Should we invest more in a business with high-return growth prospects? Should we make acquisitions to enhance a business' competitive position and long-term value? Is it the right time to shift from investing in growth to focusing on operating what we have more efficiently? Are there assets on the balance sheet that could be more effectively utilized? Is the mix of debt and equity optimal for the character of the business?

These are exactly the types of strategic and financial strategies private equity investors pursue after taking a company private. They also don't tend to be what most public-market investors are focused on. They're more likely to be concerned with how this quarter's earnings will come in relative to consensus, or what the stock's trading pattern might say about its trajectory over the next month or two.

What's going on in the business of a company that has caught your eye that tends to make it mispriced?

CR: One of our core investments is Chico's [CHS], which sells private-label women's casual clothing and related accessories targeting a somewhat older demographic. We think the stock has been depressed for two primary reasons. One is that its Soma Intimates concept, which we believe has tremendous potential as a national brand picking up where Victoria's Secret leaves off in terms of demographics, is still ramping up so the market appears not to put much value on it. At the same time, mall traffic is down in general and comp-store sales are weak, so valuing Chico's on what it did last quarter or is expected to do next quarter is relatively unexciting.

All that is fair enough, but when we look closely we see a company with four growth concepts – Chico's, Soma, White House | Black Market and Boston Proper – which is unique today in apparel retailing. It's run by Dave Dyer, who has a long history of building retail brands from J. Crew to Lands' End to Tommy Hilfiger and making big money for owners along the way. The active part of this investment revolves around a very inefficient balance sheet. Without the two large share repurchases management has announced in the past year, the company would have had 20% of its market cap in cash by the end of next year. Repurchasing stock at a discount to intrinsic value should supercharge the share value as the growth story ultimately plays out.

Our newest core position is Babcock & Wilcox [BWC], and one of the primary things weighing on its share price is that it has been investing huge sums in developing a new nuclear-reactor technology. It's not that they're wrong in pursuing the technology, but the scope of the project is just too big and expensive. They likely would have to spend another $1 billion or so to commercialize it over the next 10 years, for a company that has only a $3.8 billion market cap. Our thesis has rested in part on management recognizing that this is too big of a bet and curtailing the size of the investment.

Clifton Robbins

Non-Hostile Environment

While it's not uncommon for investors to tout their "private-equity approach" to public equities, Cliff Robbins does so with utmost credibility. He spent 17 years at top private-equity firms KKR and General Atlantic before founding Blue Harbour Group in 2004. His rationale: "The best deals I'd done had little to do with the leverage of buying the whole company, but came from backing the right management teams in situations where there was considerable scope to unlock value. If we could do that same thing without paying the 30-50% control premium and without the illiquidity involved in private equity, I thought we could do even better."

While Blue Harbour only invests in companies for which it has an activist agenda, Robbins has retained the non-adversarial approach of private equity. His firm has never waged a proxy contest and eschews board invitations. "We take a collaborative partnership approach with management in part because it's my experience, but also because it fits my personality. I want to be in business with people I like and respect." Not that there's anything wrong with the alternative, he says. "We often come across bad management teams and bad boards and while we won't invest in them, a hostile activist very well should."

What we go to great pains to avoid is trying to fix broken businesses. We're generally looking for well-managed companies with favorable industry dynamics, sustainable franchises and recurring free cash flow. Some activists seek out poorly run companies that are struggling and focus on changing management and running it all better. That's a perfectly good strategy to create value, but it's not what we do.

In this context, talk about your current investment in Allscripts Healthcare Solutions [MDRX], which went through a nasty fight with an activist in 2012, resulting in a management and board shakeup. Were you at all involved through that?

CR: This is a company we followed for a long time, one of the major players in healthcare IT and getting medical records online. Although we liked the business, the business model, the business prospects and the valuation, we didn't invest specifically because we weren't comfortable with the management team. When the newly reconstituted board named Paul Black as CEO – he'd been the COO of Cerner, one of the best companies in the space – it was one of the last pieces of the puzzle for us and we bought shares in January 2013. [*Note*: Allscripts shares, below $10 at the beginning of 2013, recently traded at around $15.20.]

If the companies you target are well managed, why aren't they doing the things you think they should to unlock value?

CR: It has a lot to do with the market caps of the companies in which we're investing. We will go up to $10 billion in market cap, but most are in the sub-$5 billion range, where management often doesn't have the internal tools and resources to develop conviction around some of the active value ideas we have. These are great operators with plenty of intellectual firepower, but when we start talking about things like maximizing return on invested capital, using a Morris Trust or securitizing real estate assets, it's clear that is not typically how they spend their day.

Companies this size also usually don't have investment banks in their ears with ideas, or many sell-side analysts looking closely at each of their lines of business. We want management teams to embrace us because we're bringing new ideas to the table. In the cap range we address, we're more apt to be able to do that.

What tools in your activist toolbox are most handy today?

CR: I would call out three areas today as particularly relevant. One is helping companies reshape the portfolio of businesses they own. American businesses are deconglomerating, often worth more in pieces than as a whole. That puts a premium on efforts to invest around strengths and divest or cut back where you don't have adequate scale or operating leverage. How best to do all that is a fertile area for activist ideas.

ON M&A:

Given the cost of capital and the cash on balance sheets, it's an opportune time for both buyers and sellers.

The second area, somewhat related to the first, is mergers and acquisitions. Given that the cost of capital is so low and that so many companies have cash on their balance sheets earning nothing, it's an opportune time for both buyers and sellers. M&A has always been a key tool for unlocking value, whether making strategic acquisitions, selling or spinning off parts of a business or selling the entire company. Many of the companies we own have a number of options available on those fronts and we believe the environment will remain conducive for them to take advantage.

The third area is optimizing balance sheets. Too many companies came into the financial crisis in 2008 overleveraged, and then spent 2009 and 2010 raising equity, lowering debt costs and cutting back on capital spending. The result, as the economy has slowly recovered, is balance sheets that have become inefficient, with too much cash and too little debt. Companies can create a lot of stockholder value by taking cash earning nothing and deploying it appropriately and prudently in a number of ways, including share buybacks, dividends, special dividends, accretive acquisitions and spending on high-return capex projects.

You're back for your second go-round at IT-services firm CACI International [CACI]. What's on your activist agenda this time?

CR: In our first iteration three or four years ago, the focus was on highlighting how a company with long-term contracts, a high-90% customer-retention rate and little to no capital-spending requirements would be much better off using its prodigious cash flow to buy back its cheap stock than to retire a 2% term loan. They ended up rethinking the capital-allocation strategy and bought back 35% of the outstanding shares. Over time the stock went up significantly and we sold.

We maintained our relationship with management, which we very much respect, and we got another chance to buy two years ago when the stock fell sharply on concerns about the government shutdown and sequestration. We thought the market was punishing all contractors indiscriminately, but our conviction was that any cutbacks weren't going to be in the cyber-security and anti-terrorism areas so important to CACI. That wasn't enough to get back in, though, we also had to have new ideas to help unlock value. We thought management should consider making a large synergistic acquisition and also consider instituting a dividend. We ended up buying 10% of the company, and six months ago it announced the $820 million acquisition of Six3 Systems, which strengthens its position in several areas and we believe will prove to be a highly accretive use of cash. The dialogue about the dividend is ongoing.

You haven't mentioned the many corporate-governance issues on which activists often focus.

CR: Part of that reflects our getting involved only with management teams we think are doing the right things, but we don't hesitate to raise issues of corporate governance when we see room for improvement. For example, one of the things we found particularly troublesome at Nabors [NBR], the oil-services firm we bought into 18 months ago, was the fact that management compensation was tied to growth in EBITDA rather than return on investment. This could incent management to invest the cash flow generated into acquisitions to make the company bigger, almost irrespective of the prices being paid. The new CEO understood that and the old compensation system has been replaced with one that much better aligns management's interests with ours as shareholders.

Why don't you take board seats?

CR: Board seats aren't a great fit with our expected two- to three-year holding period. If you go on a board you should make at least a five-year commitment, and we're not willing to do that and give up liquidity. Also, we're not hostile activists, so we don't need to be on the board as a challenge to management.

Describe your valuation discipline.

CR: There's no single discipline because companies are valued differently in the market. Our general focus is on free-cash-flow yield, which we define as EBITDA – less cash taxes and capital spending – as a percentage of market value. We think that's a good defensive way to invest as it allows our equity to accrete from that growing cash balance even if valuation doesn't change. It depends on the growth profile, but we're looking for at least a high-single-digit free cash flow yield, ideally more.

We will invest in companies that don't generate a lot of free cash flow, but in such cases will want the value supported by book value or hard assets. Nabors, for example, doesn't have a particularly high free-cash-flow yield because it has a lot of capital spending. Here the underpinning is the significant hard asset value of its rigs. Buying at a large discount to book value gave us a significant margin of safety.

In all cases we underwrite to a 30-50% return over two to three years. Some obviously do better than that and some do worse, but when we make an investment we have to believe that's highly likely.

ON FARM-TEAM POSITIONS:

I don't feel we've yet done the due diligence we need to do or built the management relationship we need to have.

Do you buy full positions right away?

CR: We always start with a farm-team position, which is usually 1-3% of our portfolio. At that point, we obviously like the opportunity, but I don't typically feel that we've done all the diligence we need to do or that we have fully built a relationship with the management team to ensure they have the desire or capability to unlock shareholder value. Generally over the ensuing quarter or two we complete that analysis and decide to either make a farm-team position a core position – meaning 6-12% of the fund – or we sell.

We see from your latest 13F a holding in Conversant [VCLK], the digital-marketing company that recently changed its name from ValueClick. Why is it on the farm team?

CR: This is a potential sum-of-the-parts play with a variety of businesses, some of which we consider more valuable than others. We have ideas in mind for how the company could unlock value, but they are still coalescing and we're still building our relationship with the management team. For the time being, it's roughly a 2% position in the fund.

Do you sell when the activist angle is no longer there?

CR: When the steps we propose have been taken and the market has appreciated it, we will sell. If the steps have been taken and the market hasn't appreciated it yet, it depends. If we conclude we got the business prospects wrong, we'll sell. But if the value is still there and we expect the market to eventually recognize it, we'll likely stick around.

Describe your latest core-position sale.

CR: We took a large position only a year ago in Brocade Communications Systems [BRCD], which provides switching solutions for storage area networks. We thought the company should do two things, reduce its cost base and return a lot of cash to shareholders, and that the stock could go from $5.50 to $10 over the next two to three years. A new CEO took over and in the past nine months announced a large cost-reduction program and a $1 billion share buyback. This is an excellent CEO and he's likely to make a lot of money from here for shareholders, but as the stock went fairly quickly above $10 and there was little left to do in terms of activism, we sold our entire stake.

What attracted your initial attention to Babcock & Wilcox.

Robb LeMasters: We had a thesis that within the industrial space there were many mid-cap companies that owned a hodgepodge of businesses that were being mispriced by the market because investors were not taking the time to examine each business individually. Good assets could be overshadowed by less-appealing businesses, and we believe Babcock & Wilcox fits that profile.

The company's core business, providing nuclear-propulsion systems to the U.S. Navy for submarines and aircraft carriers, is inarguably a good business. B&W is the sole-source supplier of these systems, supporting very long-term build and maintenance programs for the Navy at a time when defense spending is shifting from desert-related to maritime-related preparedness. As a sole supplier it has more control over pricing than many defense contractors. This business has earned 20% operating margins that we believe are sustainable, and generates roughly half of the company's overall operating income.

The second-largest business, generating one-third of operating income, is providing boiler equipment, parts and services to coal-fired power plants. Half of this coal-related business comes from aftermarket parts and services and is under pressure as tougher U.S. environmental regulations cause operators to shut down coal plants – an estimated 15-25% of these plants will be closed over the next five years. The impact to B&W will be less than that, however, because these on-life-support plants generate only minimal aftermarket business today.

For the other 50% of the coal business – building coal-fired plants overseas and selling environmental-control products and services – there's actually a growth case. Two significant EPA rules come into effect this summer that will prompt increased spending on environmental control for B&W's large installed base in the U.S. At the same time, the new-build market is alive and well in many parts of the world, such as India and Southeast Asia, where coal is still far more cost effective than using higher-priced natural gas.

Swirl all that up and we think the worst case for the coal-related business is that its revenues bottom at roughly $1.5 billion this year and stay there. We recommend the company focus on extracting the most profit out of this revenue by adjusting the cost base. Benchmarking against peers and analyzing the manufacturing footprint, we believe through cost cuts they can increase operating profits by more than 20% even in the absence of revenue growth.

What do you recommend they do with mPower, the R&D initiative Cliff mentioned earlier?

RL: The good news is that the company's Small Modular Reactor technology has great promise and that B&W seems to be in the lead in designing a prototype. But as Cliff mentioned, we believe the investment necessary to bring it to fruition is too high. We thought there were two options to reduce these losses to a more manageable level. One, bring in additional partners to take its 90% stake in mPower – Bechtel owns the other 10% – down to 15-20%. Two, reduce the scope of the project to develop only the core technologies and then in a couple of years revisit how to proceed from there. The company actually announced earlier this month it will pursue this latter path, taking its expected mPower spending down to $15 million per year from a current annual run rate of $60-70 million.

What upside do you see in the shares from today's price of $34.70?

RL: Management's EPS guidance for this year is $2 to $2.20. We already think that's conservative, but reducing the mPower investment to $15 million would add another 30 cents in per-share earnings. Right-

INVESTMENT SNAPSHOT

Babcock & Wilcox
(NYSE: BWC)

Business: Manufacture and servicing of utility, industrial and military power-generation systems that utilize nuclear, fossil-fuel and renewable energy sources.

Share Information
(@4/29/14):

Price	**34.69**
52-Week Range	26.28 – 35.40
Dividend Yield	1.2%
Market Cap	$3.83 billion

Financials (TTM):

Revenue	$3.27 billion
Operating Profit Margin	15.6%
Net Profit Margin	10.6%

Valuation Metrics
(@4/29/14):

	BWC	S&P 500
P/E (TTM)	11.3	17.9
Forward P/E (Est.)	13.4	15.7
EV/EBITDA (TTM)	5.8	

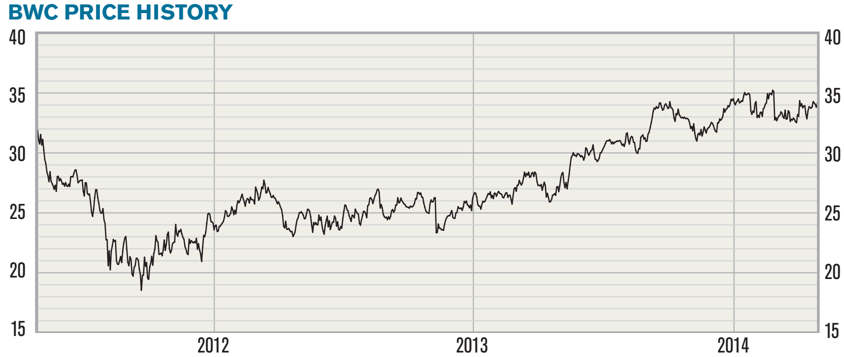
Largest Institutional Owners
(@12/31/13):

Company	% Owned
T. Rowe Price	14.5%
Mason Capital	10.8%
Perkins Inv Mgmt	6.0%
Vanguard Group	5.4%
Glenview Capital	5.0%

Short Interest (as of 3/31/14):

Shares Short/Float	14.8%

BWC PRICE HISTORY



THE BOTTOM LINE

Robb LeMasters believes the market overestimates the downside in the company's coal-related business and underestimates the upside in its defense business, from cost savings on a large R&D initiative, and from buying back shares. Putting a market multiple on his $3.50 per share earnings-power estimate, the shares would trade at around $50.

Sources: Company reports, other publicly available information sizing the coal-related power-generation business can add another 25 cents in earnings power. We also believe they should start reducing the share count before the operating improvements are visible. They have the capacity to do so by adding one turn of leverage from the current net-cash position on the balance sheet.

With all that we consider earnings power to be around $3.50 per share. At a market multiple, that would result in a share price of around $50.

Key risks?

RL: The bear case is that the coal business takes another leg down, which we don't believe will be the case. I think people also look at this and say even if we're right and there's upside to earnings, the lack of revenue growth means it will always be stuck at today's 11-12x multiple. Our view is that if you can grow earnings at double-digit rates for a few years and people put more emphasis on the non-coal businesses, assuming a market multiple isn't a big stretch.

Describe what you think the market is missing in Tribune Company [TRBAA].

Todd Marcy: We started looking at Tribune last summer, six months or so after it came out of a long and torturous bankruptcy and restructuring process. The basic story here is of an under-the-radar company trading on the pink sheets that has a number of assets with considerable value and a very capable management team pursuing a variety of initiatives to unlock it.

Following the spinoff of its newspaper business, expected in June, the company's primary operating business will be local television broadcasting, where it is the largest single owner of local TV stations in the country. It also owns 31% of the Food Network, the dominant food cable channel, 32% of CareerBuilder, the leading job-hunting website, and 28% of the online classified-ad business Classified Ventures,which among other things owns Cars.com.

What's interesting about being a local TV broadcaster?

TM: The advertising side should continue to grow more or less in line with the economy, as it has over the past decade, with swings up and down every other year due to political advertising spending. What's far more interesting is Tribune's potential to increase the retransmission fees it receives from cable, satellite and phone-company service providers for the right to air its local stations. These agreements are negotiated every three to five years on a per-subscriber basis, and by virtue of its greater scale after the December acquisition of Local TV Holdings, Tribune will have significantly more leverage in negotiating new rates. The company has also in general been a little slow on the uptake in this area, in large part due to the turmoil of the bankruptcy process. Overall, we think revenue from retransmission fees – most of which falls directly to the bottom line – can double over the next three to four years.

The company recently announced the sale of partly owned Apartments.com. Are other minority stakes on the block?

INVESTMENT SNAPSHOT

Tribune
(OTC: TRBAA)

Business: Operator of commercial television stations and newspapers in the U.S. Currently plans to split publishing assets from TV assets by mid-year 2014.

Share Information
(@4/29/14):

Price	**77.00**
52-Week Range	52.87 – 84.85
Dividend Yield	0.0%
Market Cap	$7.17 billion

Financials (TTM):

Revenue	$2.90 billion
Operating Profit Margin	13.3%
Net Profit Margin	253.2%

Valuation Metrics
(@4/29/14):

	TRBAA	S&P 500
P/E (TTM)	31.9	17.9
Forward P/E (Est.)	15.6	15.7
EV/EBITDA (TTM)	19.1	

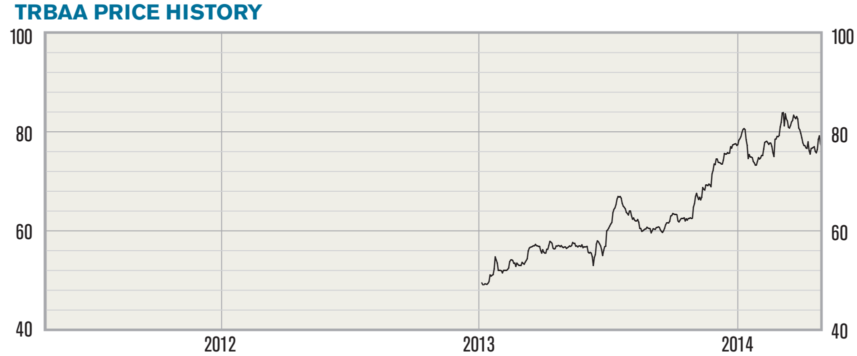
Large Institutional Owners
(@12/31/13):

Company	% Owned
Franklin Templeton	4.0%
Primecap Mgmt	2.4%
Advisory Research	1.9%
TIAA-CREF	1.2%
Cramer Rosenthal McGlynn	1.1%

Short Interest (as of 3/31/14):

Shares Short/Float	n/a

TRBAA PRICE HISTORY



THE BOTTOM LINE

Having endured a torturous restructuring process, the company now has a very capable management team pursuing a variety of initiatives to unlock considerable asset value that the market isn't recognizing, says Todd Marcy. His base-case sum-of-the-parts analysis yields an estimated share value within the next 18 months of around $110.

Sources: Company reports, other publicly available information

TM: There has been speculation in the press that Cars.com is being shopped, but our basic view is that it, Food Network and CareerBuilder are all well managed and will continue to accrete in value. So there's no hurry for Tribune to sell, but at the right price any asset could be sold to unlock value.

Are you fully trusting management's discretion on this front?

TM: This isn't a case where we have a list of the things we believe management and the board should be doing and they aren't. We hold both the Chairman, Bruce Karsh of Oaktree Capital, and CEO Peter Liguori in very high regard. Our interests are fully aligned with theirs and we expect them to make the right decisions at the right times on any asset dispositions.

Are there other value-unlocking initiatives in the works?

TM: They have hired a dedicated real estate team whose sole purpose it to figure out how best to monetize the company's real estate assets, which include landmark buildings in big markets like Chicago and Los Angeles. In addition, they're investing in WGN to expand its distribution as a national cable channel and to develop original scripted content, the first effort of which, *Salem*, just premiered. They also see potential to take considerable cost out of the local broadcasting business following the Local TV acquisition.

How are you valuing the shares, now trading at $77?

TM: We look out to the end of 2015 at what the various businesses will be earning in EBITDA and then apply peer multiples to value each piece. Local broadcasters, for example, trade at an average forward two-year EV/EBITDA multiple of around 9x, which on our 2016 and 2017 estimates for the station business gives us a value of roughly $60 per share. Cable networks trade at 12x EV/EBITDA on a forward basis, which on our estimates for Tribune's share of Food Network yields a value of about $23 per share. Add to that the value of the newspapers, the other minority investment stakes, the real estate, and the cash we expect them to generate this year and next, and our base-case share value comes to $110.

I'd mention two other sources of potential upside not included in that. One is the company's ownership of excess wireless spectrum, which would be of significant interest to wireless providers such as AT&T and Verizon because it is high-quality 600-MHz spectrum in some of the country's largest markets. There's still a lot of uncertainty around whether the auction rules will prove attractive enough for broadcasters like Tribune to participate, but if they do, the option value is potentially quite interesting.

ON GARBAGE:

If you have strong local-market positions and are vertically integrated, this can be a very good business.

We also see starting in 2015 substantial opportunity for capital return to shareholders. The company throws off a lot of cash – the free-cash-flow yield today is around 9.5% – and rather than completely pay off debt, we'd expect management to buy back shares and/or institute a dividend.

Turning to a somewhat less glamorous sector, why do you see upside in Progressive Waste Solutions [BIN]?

RL: This is a waste-hauling business operating in three primary regions. Roughly 50% of operating profits come from Canada, 35% from Gulf-coast areas of the U.S. south, and 15% from the U.S. northeast, principally around metropolitan New York City.

If you have strong local-market positions and are vertically integrated from collection through to disposal, the waste-management business can be a very good business, with recurring revenues, barriers to entry, pricing power and stable growth. That's largely the situation for Progressive in its two largest regions, but not as much the case for it in the U.S. northeast, which we believe is obscuring how attractive the rest of the business is.

What do you prescribe for fixing that?

RL: Key to success in this industry is vertical integration, which means not only owning collection, but also owning strong processing, recycling and landfill assets. In the northeastern U.S. the company needed to consolidate share on the collection side so it would have a higher percentage of internally controlled and sourced waste going into its landfills, allowing it to be more price disciplined. They have successfully addressed that through acquisition, and while we haven't yet seen any fruits of that labor, we believe over the next year or two that EBITDA margins in the region, now below 20%, can approach the mid-20s.

What else is on your activist agenda?

RL: We have suggested the company – like big competitors Waste Management and Republic Services – scale back on M&A and focus on small tuck-in acquisitions and driving up ROIC on its existing assets. Recent changes to the compensation structure to focus managers on EBIT and ROIC metrics rather than EBITDA growth is a positive step in that direction. If we benchmark Progressive against peers, even in its good regions we see the potential for 200 to 300 basis points of operating-margin improvement in the U.S. south and 100 to 200 basis points upside in Canada.

At a recent $24, how cheap do you consider the shares?

RL: Peers trade at 8.5x EV/EBITDA, which on our 2016 estimates would result in a year-end 2015 price target in the low-$30s. While that's not huge upside

INVESTMENT SNAPSHOT

Progressive Waste Solutions
(NYSE: BIN)

Business: Provider of waste-collection and landfill-disposal services for commercial and residential customers in Canada and the southern and northeastern U.S.

Share Information
(@4/29/14):

Price	**24.04**
52-Week Range	20.42 – 27.18
Dividend Yield	2.2%
Market Cap	$2.76 billion

Financials (TTM):

Revenue	$2.03 billion
Operating Profit Margin	11.2%
Net Profit Margin	5.8%

Valuation Metrics
(@4/29/14):

	BIN	Russell 2000
P/E (TTM)	23.6	101.6
Forward P/E (Est.)	19.2	18.8
EV/EBITDA (TTM)	8.3	

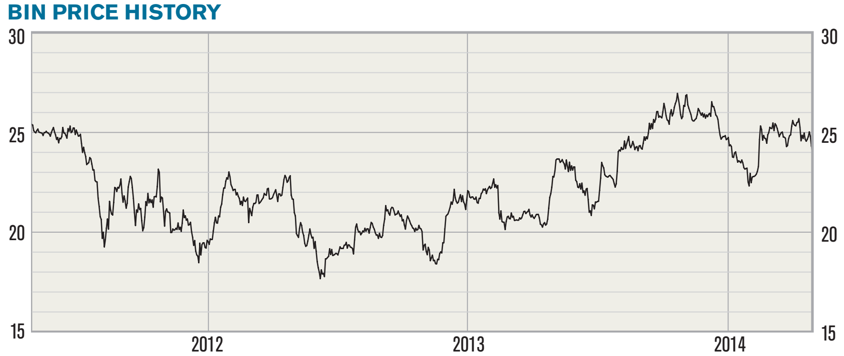
Largest Institutional Owners
(@12/31/13):

Company	% Owned
Sentry Select Capital	7.1%
SPO Advisory	6.6%
Blue Harbour Group	6.1%
Norges Bank	5.3%
Royal Bank of Canada	3.9%

Short Interest (as of 3/31/14):

Shares Short/Float	n/a

BIN PRICE HISTORY



THE BOTTOM LINE

The company should be able to expand margins as it consolidates its market positions and focuses on operating efficiency after years of acquisition-driven growth, says Robb LeMasters. At a peer EV/EBITDA multiple on his 2016 estimates – which don't assume a cyclical volume uptick he believes is possible – the shares would trade in the low-$30s.

Sources: Company reports, other publicly available information

from today, we think the steadiness of the business limits our downside and we see optionality to the upside if the economic cycle generates the late-cycle volumes often forecasted by industry analysts.

Explain that.

RL: This is an industry that for a very long time prior to the financial crisis showed unit-volume growth that ticked along at an average 1-2% per year. When the crisis hit, volumes fell 5-10% and they haven't fully recovered, leaving people to wonder if there's a secular problem. We believe the downtick has primarily been a function of reduced construction/demolition waste, which will turn into a cyclical positive as residential and commercial construction eventually returns to normal. In a capacity-utilization business like this, higher volumes tighten up pricing, resulting in significant operating leverage. So even a slight cyclical volume improvement can have an outsized impact to the upside on earnings power.

From garbage to Internet infrastructure, describe your investment case for Akamai Technologies [AKAM]?

TM: People classify Akamai as a CDN, or content delivery network. The company likely has the largest distributed computing network in the world, with more than 150,000 servers in 80 countries, and essentially provides services that accelerate and improve the delivery of content and applications over the Internet. It is perhaps more purely levered to the growth in Internet traffic than any other business – a pretty attractive position when Internet traffic is growing at better than 30% per year and shows no sign of slowing down.

In any business with such secular growth, one key issue is obviously the threat of new competition. Akamai currently has 60-65% share in its markets and is headed toward $2 billion in annual CDN revenue, while no one else has more than $250 million. The breadth of its network is a significant barrier to entry, and it has also taken advantage of its size to both outspend everyone on R&D and to pass on cost efficiencies to customers. All that has made it difficult for even giant competitors to establish a foothold: AT&T spent ten years and close to $1 billion trying to create its CDN business before eventually deciding to essentially just resell Akamai's services.

There has also been concern that Akamai's customers will eventually do for themselves what they pay Akamai to do today. Our first response to that is that the company has a well-diversified customer base, with Apple probably the largest and accounting for no more than 5% of total revenues. In addition, while giant media players like Google and Netflix have gone it alone – the latter of which seems to be having some issues on the content-delivery front – the vast majority of companies will never be able to justify their own CDN on either a cost or performance basis against what Akamai can deliver.

What should the company be doing that it isn't?

TM: Management has been addressing the two areas we've been focused on for value creation. One, it's been putting dormant cash on the balance sheet to productive

INVESTMENT SNAPSHOT

Akamai Technologies
(Nasdaq: AKAM)

Business: Sells and maintains content-delivery products and services meant to improve website performance and security for online e-commerce and content providers.

Share Information
(@4/29/14):

Price	**52.48**
52-Week Range	40.08 – 63.15
Dividend Yield	0.0%
Market Cap	$9.37 billion

Financials (TTM):

Revenue	$1.58 billion
Operating Profit Margin	26.5%
Net Profit Margin	18.6%

Valuation Metrics
(@4/29/14):

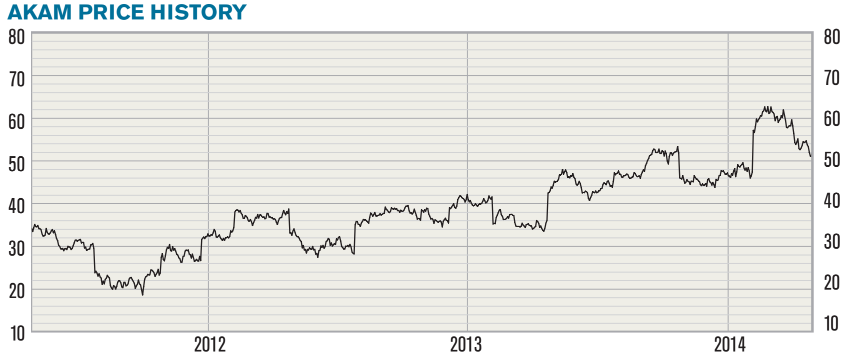
	AKAM	S&P 500
P/E (TTM)	32.6	17.9
Forward P/E (Est.)	23.5	15.7
EV/EBITDA (TTM)	16.2	

Largest Institutional Owners
(@12/31/13):

Company	% Owned
T. Rowe Price	15.1%
Vanguard Group	6.5%
Wellington Mgmt	6.4%
Morgan Stanley	4.6%
State Street	4.3%

Short Interest (as of 3/31/14):

Shares Short/Float	3.2%



THE BOTTOM LINE

The company is "perhaps more purely levered to the growth in Internet traffic than any other business," with stronger barriers to competitive entry than the market appears to believe, says Todd Marcy. Putting what he considers a not-unreasonable 20x P/E multiple on his 2016 EPS estimate and adding net cash, the shares would trade at $73.

Sources: Company reports, other publicly available information

use, six months ago announcing a $750 million stock buyback plan, and in December buying Prolexic Technologies for $370 million to expand its cybersecurity offerings. Two, it is taking steps to reduce its cost of capital by adding some debt to the capital structure with a $690 million convertible-debt offering in February.

Is this one of those cases Cliff mentioned where value-creating steps have been taken but the market hasn't appreciated it yet?

TM: The shares at around $52-53 are up quite a bit from our entry point early last year in the low- to mid-$30s, but we still believe there's significant upside left. We think they can do $3.25 in EPS in 2016. If we put a 20x multiple on that – not unreasonable for a company growing its bottom line at 20% per year – and add in the $8 per share in net cash that we estimate the company will have by year-end 2015, the stock would trade at $73.

This is clearly more of a growth story than most positions in our portfolio, but that target 18 months out is based on a conservative relative P/E compared to the broader software universe. If you look today at other $5-billion-plus-market-cap software companies that are growing at rates commensurate with Akamai's, VMware trades at 26x forward earnings, Cerner at 31x and Red Hat at 32x.

Activism as an investment strategy appears to be in an ascendant phase. Why do you think that's happening?

CR: I think there are two primary reasons, the first of which is that it has been a high-return strategy. Most of the large institutions investing in activist funds operate under directives to earn 7-8% per year overall while keeping one-quarter to one-third of their money in fixed income. That puts considerable pressure on the return they need from their equity portfolios. There's only so much you can do in private equity because it's illiquid, so strategies like activism that have been earning high returns attract a lot of money. I would consider that more of a cyclical phenomenon.

The more important driver, though, is a sea change since the 2008 financial crisis in corporate governance. Poor corporate oversight by boards played an important role in the crisis, so today both directors and large investors recognize the importance of respecting and asserting shareholder rights. That opens and broadens the dialogue between shareholders and companies, a change that I think is permanent. We won't go back to a world where stockholders don't matter, transparency is limited and the CEO fills the board with golfing buddies. That will continue to drive the opportunity set for activism.

Is that going to mean more competition for you?

CR: Activism is very hard to do well. You need to have credibility with management teams. You need to have experience working on and with boards. You need to have a large support network. It's too early to know exactly how it plays out, but experience matters a ton, so I'd expect the dozen or so activists who have prosecuted the strategy successfully for a long time to continue to be able to so. VII

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