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JIM OSMAN

Founder & Chief Executive Officer
The Edge Consulting Group

{ INTERVIEW BY KHAI NGUYEN }

Jim founded The Edge in 2005 and leads the analysis and ideas process. He is passionate about ensuring that the analysis is geared towards 'real situations' and offers more than just a buy or sell-side analyst's view. Jim brings to The Edge two decades of portfolio management experience in the securities and fund management industry.

His vast expertise includes special situations and Spinoffs, as well as specialized equities and derivatives hedge funds. His previous roles included portfolio manager of a London based special situations fund focusing exclusively on Spinoffs, portfolio manager at a highly regarded specialized equities and derivatives hedge fund based in Chicago, and an equities and derivatives trader at one of the largest French banks. Jim studied Investment Management at The London Business School.

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Khai Nguyen: Jim, welcome and thank you for joining us.

Jim Osman: Thank you very much.

KN: You founded The Edge in 2005 to provide investors with access to insights into Global Special Situations. What makes that space so compelling for investors to look at?

JO: A special situation in our view is a name where we believe there is a gap between price and value and moreover a catalyst, or multiple catalysts to bridge that gap that is normally hidden. It makes sense for investors to look at these situations for a number of reasons. Firstly, the coverage is limited. The traditional mainstream buy, sell, and hold community usually ignores what is unseen and therefore they are often overlooked. Secondly, even if they are spotted they can be wildly misinterpreted and valued incorrectly. It takes expertise to do it. Lastly, and I guess quite importantly, they often provide superior returns above and beyond the index.

As a portfolio manager for many years I never saw a comprehensive service that covered the interesting special situation names out there. The broker community was, and still is in my opinion, pure vanilla buy, sell and hold. This approach can mean anything on an investment perspective. On the larger cap and more well covered names it means even less. Consequently, the large big bank research has shrunk significantly because it has limited value add. The Spinoff Report, as it was formally known and now The Edge, has a 'why' to its existence. Something most research providers are without and this is key. We aim to provide an insight to our partners by understanding and analyzing the situation fully and if warranted, present it as an investment opportunity in this under covered space.

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KN: Why is that space so under covered by investors?

JO: In a word, it's understanding. Generally we try to identify a profit opportunity for the benefit of the investor and specifically, and most importantly, our partners. The mainstream research community doesn't push the envelope enough. We try to challenge the status quo. We try to identify the edge in this situation. We don't "cover" stocks. A second key point is packaging up the situation to show that it has been fully analyzed with a clear precise view as to what to do. Investors and people generally will shy away from what they don't understand and quite rightly so.

Too many firms push the word experience and years of it. The word has limited value to me. Having experience is not enough. The experience has to be transformed into expertise. It's one of our core values and I firmly believe it. I often say to potential partners: we don't sell spinoffs or special situations—we present investment ideas.

KN: You partnered up with Deloitte on a white paper to study corporate spinoffs. In that paper, you stated "We find that the Spinoff value creation is not dependent on the pace of economic growth." Why is that?

JO: The report was a real insight into this type of corporate activity and very pioneering in its approach as we had no preconceptions. We just wanted to find out some additional facts to add to our analysis and really determine whether or not these situations made money, regardless of any analysis.

Spinoffs are an interesting phenomena. There are of course sector spinoffs in certain areas such as the ones we have seen recently in the oil and the REIT industry. However, there are others that are not really dependent on macroeconomics and that's why they are worth looking at. Companies spinoff for a variety of reasons. Recently, a lot of companies have taken this route because the IPO market is so difficult.

KN: How then, do you determine which companies will create position value as opposed to destroying value? What are the key metrics that you and your team use to analyze them?

JO: We are pretty open about how we analyze and would encourage investors to look along similar lines. Traditional valuation techniques are not enough. Some value stocks can stay cheap forever. We look at three things. First, we look at relative and forward valuations. Most importantly we use our own numbers. The P&L, the balance sheet. Bottom-up work. We would encourage every investor to do the same. Numbers coming down the pipeline are often inaccurate. Second, we further look into the technical nature of the stock. I mean this from a share displacement point of view. For example, in a spinoff situation, the amount of technical buying or selling that can occur on the event, specific firms who hold the name and their reasons for doing so. Also, technical outcomes of share prices due to the catalyst event under various scenarios. For example, we are one of the few who follow the John Malone names. His situations are extremely interesting on the basis you can understand them. He is a true value creator so you are off to a good start already. The key here is the play on a technical nature as well as accurately valuing what is going on. Lastly, we look at the insider interests. Too many investors look at sales. They mean very little. Insiders sell for a variety of reasons but they buy for only one reason. Look at open market purchases and consider the history of the insider. Have they been any good in the past at buying their own shares? Are they a value or catalyst buyer historically? Also, what are their incentives going forward? Is the management credible? How do they benefit from a rising share price? The best spinoffs have a high insider interest backed by open market purchases.

KN: One of the metrics you've looked at is shareholder activism. Since this has been a hot topic as of late, how does this affect how you look at companies and where do you see this trend going?

JO: Speaking with a number of activist clients, the trend is definitely up. Investors may be surprised to know that a lot of public companies are managed very inefficiently. It's a fact. As long as that exists, the ability to create value must either come from the management or the shareholders. If the management cannot do it, it's low hanging fruit for the activist. Culturally I believe that it's more difficult for U.S. activists, which are the majority, to work with or bully European companies. It's true that a lot of European names are right for corporate change, but unfortunately the cultural barrier doesn't work in reality and the high number of family shareholders in Europe make it very difficult to force a change. The shareholders in a great number of names don't seem to care too much either. It's something rarely, if ever, spoken about but it's true. The success of U.S. activists in Europe has been very low. We have identified ways in which this could be improved.

KN: How do you analyze which activists will be successful or not?

JO: That's a great question. I think a good activist needs to, amongst other things, have two targets. Firstly, a viable

fundamental upside to the stock and secondly, an investor base that wants to change. I believe too many activists don't take into account the second part and they fail. For example, it's one of the reasons that U.S. investor pressure on European names are not so successful. They tend to underestimate the general apathy of the shareholder.

In our analysis, we certainly look at past history and the background. However, we have started a study that will evaluate 15 years of activist involvement to determine as to whether this type of investor is really value creating. I'm really looking forward to it and our partners are too. As with the spinoff study, it will help our partners make informed investment decisions knowing the facts. Incidentally, we aim to follow up with an M&A and an Insiders study later in 2015.

KN: You've been on record stating that spinoffs should be its own separate asset class. What makes them so different from other asset classes and why hasn't it been more widely adopted in asset allocation decisions?

JO: It should be. For us, and it sounds a cliché, they are so different. There are multiple industries and many ways to look at the valuations. Along with this, examining the technicals and investigating the new management are all ingredients that go into making a recipe that has to be analyzed. Along with the event and name being totally new to the market, how can't this be a source for new, good and interesting investments?

I think it hasn't been adopted because they are hard to track and analyze. Investors, banks and funds can do it but it's difficult and time consuming. All the information is out there—you just have to look. Not all spinoffs make money. Our study showed that 4 out of 10 spinoffs didn't make a positive return in year 1.

KN: What are your thoughts on what John Malone has accomplished with Liberty?

JO: John Malone is well respected here. Malone has an outstanding track record as one of the world's best capital allocators, which isn't topped by any other CEO including Warren Buffett. At the helm of Tele-Communications, Inc. (TCI), he returned its shareholders 30.3% per year from 1973 to 1998 before selling TCI to AT&T for \$60 billion, making it one of the public companies with the best 25-year track record during that time. In comparison, Berkshire Hathaway (BRK.A) generated a slightly better return of 31.1% while the S&P 500 return was a meager 9.8% during the same period. This is not known to most people.

The recent period for John Malone-controlled entities has been outstanding with Liberty Global (LBTYA), Starz (STRZA), DIRECTV (DTV) and others now totaling over \$100 billion in market value. In fact, our analysis shows that investors have

made more money under John Malone when compared to Warren Buffett. Having said that, he does make it difficult for the regular investor to understand what he is doing.

KN: You have been big proponents of using empirical evidence and historical data in your research process. How do you measure your performance and prove your track record?

JO: We have been very big advocates of using the facts to make our decisions. If you analyze the facts and not hearsay, you can get the real picture of what's going on. Our track record is exemplary and as it stands, we are one of the few firms in the world that track our recommendations. I believe it could be much better. We don't leverage, trade or hedge our model portfolio. We have had many of our partners suggest that we manage money and use these additional skills. It's the main reason why we are spinning off part of the business into a separate entity and looking to create a fund that will concentrate on this very specialist area of investment. Partners have demanded it which is always a good reason and goes back to our 'why'.

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KN: What are some of the ways your clients are leveraging your expertise and research?

JO: Our partners are varied in size, region, specialty and investment horizon. It keeps us on our toes in terms of what ideas we put out to them and more importantly how they are serviced. It's also real added value for them as each one directly benefits from our market intelligence and view. It also enables us to be very flexible and change the product offering very quickly due to demand or a changing market. We have a simple rule. If more than two partners request something and we believe it makes sense, then it's in. For example, some indicated they would like to see more in depth into the insiders. We now write more and I think the research is better for it. Others wanted more special sits. We produce more than anyone else in this area now. We like to think of our firm as a specialist club. Not everyone gets access to it. Having said that, if you are invited you are expected to take our call and use our research by acting upon it.

KN: And with that, I want to open it up and ask you questions submitted by the Harvest investment community.

With your 20 plus years of experience in spinoffs and special situation investing, what are some of the reoccurring themes that you have seen play out over and over?

JO: I would like to list them all here if I could but I don't really see a lot of reoccurring themes to be honest. There always seems to be a different angle or something which I like to look at that will provide some sort of value. I believe that the experience of seeing so many interesting situations enables not only myself, but more importantly the team, to spot opportunities for our partners.

KN: It seems like spinoffs and special situation investing requires a lot of specialized skillsets to uncover opportunities. What is it about you and your team that allows them to do so successfully?

JO: I think more than anything, we have a process. We look at situations either from a bottom up or top down point of view. Ultimately, it enables us to find what is interesting about the event. The trouble with so much research these days is that it doesn't get to the point quick enough and the most interesting parts are ignored. I think where we are good is that we look beyond the status quo and identify the edge, hence our name.

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KN: Can you talk about a spinoff or special situation that didn't work out as planned and explain why?

JO: Our analysis is fundamental bottom-up. Along with most who use this, it doesn't take well to big changes in macroeconomic trends. The oil price move recently was one where this was the case. A lot of fundamentally good companies got hammered. Arguably, you increase your position on these sorts of moves but when the changes are quite big it can lead you to doubt your analysis sometimes. Fortunately, we have a track record of winning for our partners and that's what we go back to—our basic principles. We are prepared to say we don't get everything right. It's knowing when to cut the wrong ones that is the key.

KN: What is your opinion on the automation and quantification of the research process, even for fundamental investors, that's been pushed lately?

JO: I haven't got a great view. Whether you are a quant or fundamentally driven investor, if your style works for you, keep going. Why change? I don't think you can ever automate what we do. There is too much human element in the research process. It's a skill that cannot be learnt by a machine.

KN: Are there any types of situations in particular, such as spinoffs, activism or turnarounds that have notably delivered value in excess of other types of situations?

JO: Our spinoff study has produced a number of important suggestions for use with our fundamental analysis. Statistics like 2 out of 10 spinoffs get taken over within 2 years and 40% of spinoffs make more than 20% in the first year after being separated are really valuable to our analytical thinking. These are truly valuable situations. However, we have embarked on three more studies to include: M&A, activism and the insiders. When we get the facts out, ask me then. I have my suspicions at this stage.

KN: How would you suggest an investor approach positioning spinoffs and special situations in their overall portfolio?

JO: I would say do your own work. Everything is a guide. If you have done as much work as you can and used as many resources as your budget will allow and you get as many signposts pointing in the right direction as possible, then execute with conviction. We tell this to every one of our partners, large or small. On a portfolio basis, and considering you may not look at special situations the whole time, a good allocation for the strategy would be 25 to 30% of your portfolio.

KN: Any last insights for investors looking into spinoffs and special situations in the next year?

JO: Having the biggest pipeline ever, I'm positive that there will be a few fantastic investments. I would urge investors looking at these situations to stick to the real businesses. The ones you can properly value and have real tangible balance sheets that can be analyzed.

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