

Hedge Fund Heavy: Is your company lazy or inefficient? Then watch out for Peter Puccetti

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Peter Puccetti looks tense. It's a bright early September morning, and he's here in his bare-bones office at Goodwood Inc. -- the Toronto-based hedge fund he founded in 1996 -- waiting for the end game in a proxy fight he launched a few months ago to play out. The target company: Cenveo Inc., a struggling envelope and packaging products firm based in Colorado. "There's been a long period of completely unacceptable performance," he says, grinding his fist into the palm of his hand. Puccetti's demands on the US\$500-million company are simple, but firm. He wants the board to take a hike so he can install a new group of directors -- and a hand-picked chief executive officer -- to sort out the company's ongoing problems. The gambit, in fact, will come to a conclusion in a matter of days. But for now, Puccetti has to be patient.

Angular and anxious, Puccetti, 39, sounds more like an NHL enforcer than the closest thing Canada has to a celebrity in the traditionally secretive world of hedge-fund management. But ever since his expertly orchestrated battle against the board at Vancouver-based printing technology firm Creo Inc. -- aided and abetted by legendary U.S. turnaround specialist Robert Burton -- he's become Canada's leading exemplar of a trend that's seeing hedge funds add a new strategy to their arsenal: seizing control of underperforming firms and fixing weak share prices by managing the companies themselves.

Taking their cue from the wave of shareholder activism that's swept the markets in the past few years, such funds are emerging as a new breed of player. Their strategy? Buy shares in a company damaged by poor management, launch a proxy fight to gain control of the board and, assuming the plan to fix the company works, watch the share price soar. That isn't unusual in itself. But today, hedge funds are buying into firms specifically to launch proxy battles, rather than use them as a last resort, and they're often fighting with stakes of less than 10%.

The trend is well-established in the U.S., where BusinessWeek reports hedge funds announced deals valued at US\$30 billion for 23 companies in 2004. U.S.-based firms such as Pirate Capital, Crescendo Investments and Cerberus Capital Management have been active in Canada, as well, launching dust-ups at

several companies, including the recently settled proxy battle at Geac Computer Corp. Ltd., the looming fight at Intrawest Corp. that's set for a shareholder vote on November 7, and the infamous struggle for control of Air Canada in 2004. But only a handful of homegrown managers are testing these activist waters. Puccetti is among the first, and he plans to swim in them for a while to come. "In a lot of companies, there's a disconnect between management's agenda and what's good for their shareholders," he says. "We think a large part of that is typically because you've got situations where management doesn't own shares in the company. Management is much more interested in building an empire, getting bigger for the sake of getting bigger."

Puccetti, the son of a philosophy professor, grew up in Halifax. After earning a degree in economics from Dalhousie University in the late 1980s, he set his sights on a career in the securities industry. He wound up with 117 rejection letters -- he keeps many of them mounted on a wall in his office -- before landing a job at First City Trust in 1988. From there, he jumped to Sprott Securities and spent three years working as an analyst, before striking out on his own as a founding partner in Puccetti Farrell Capital Corp., an investment banking firm. The company prospered, but Puccetti didn't find the work satisfying. In 1996, he and his partners pulled the plug. That same year Puccetti founded Goodwood Inc.

Although Goodwood has been in business for nine years -- with \$300 million under management and an annualized return of 23% -- its activist attitude is a recent development, the catalyst for its change being a simple piece of bad luck. In 2002, Puccetti bought shares in Creo, a digital-imaging company that was turning in poor financials despite its status as a world leader in its field. Puccetti believed the company was on the verge of passing some crucial milestones, but the good news never materialized. Before long, Creo's shares started going south.

"What really ticked it for us to become activist investors was that management had taken a new direction strategically," Puccetti recalls. "They were going into business that was a real departure from what the core strengths of the company were. It put

them in competition with three of the biggest players in the space, who had vastly better resources. To us, it looked like a really weak move."

Realizing he needed more leverage if he was going to get anywhere with the company, Puccetti went looking for an ally. Eventually he met Burton, who was renowned for the turnaround he engineered at printing behemoth Moore Corp. that resulted in the slashing of 3,000 jobs and the tripling of the company's share price. Puccetti and Burton hit it off and, with about 6% of Creo's outstanding shares between them, launched their proxy battle last October, with the objective of dumping the board and installing Burton as the new chief executive. Creo's shares took off -- a clear signal that investors were on side.

In the end, however, Puccetti and Burton didn't have to follow through on their threat. In February, less than two weeks before the shareholders were set to vote for Puccetti and Burton's slate of new directors, Eastman Kodak Co. arrived on the scene with an offer to buy Creo for about \$20 a share -- double what they had been trading at six months earlier. For Puccetti and Burton, it was a home run, a perfectly choreographed piece of activism, right down to the entry of Kodak as the white knight with the chequebook. "Bob Burton was the key," Puccetti says. "If we didn't have such a threat, the company wouldn't have felt compelled to sell itself."

While the move turned Puccetti into a celebrity and cemented his relationship with Burton, not everyone sings his praises. "I think he was just tagging along with Burton and the bandwagon," sniffs one industry insider. Veterans of the deal disagree. "Peter's a bright guy who's done well for himself," says Burton's son, Robert Jr., president of the family's business, Burton Capital Management. "He and his team have a good track record, and they've been very helpful to us." Puccetti also waves off critics, but adds that he shouldn't get all the credit: Key decisions at Goodwood are shared with its CEO, Cameron Macdonald, a former director of Connor Clark Private Trust, and senior analyst Rob Kittel, a chartered accountant. Puccetti concedes, however, that as the firm's founder, he gets final say.

In any case, he and his team are determined to uncover more troubled companies. They'll also be working closely with Burton in the months ahead. As a result of the Cenveo proxy battle -- the board capitulated a few days before Puccetti and Burton's demands went to a shareholder vote -- Burton is being installed as the company's CEO. Essentially, this is the same plan Puccetti and Burton proposed at Creo. This time, however, there's no white knight to buy the company. At Cenveo, they'll be fixing things themselves. And if they succeed, you'll be hearing a lot more about Peter Puccetti.