

BARRON'S Hedge Funds

A Monthly Report

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"Go-anywhere"
fund manager
Nathaniel
August thinks
Puerto Rican
debt may be the
new hot spot.

Talking With Nathaniel August

Founder
Mangrove Partners

A Born Investor

by Eric Uhlfelder

SOMETIMES IT'S IN THE GENES. NATHANIEL AUGUST'S mother, Nancy, was one of the first female partners in a big asset manager, Wellington Management, back in the early 1980s. His father, Donald, was an original partner in another Boston investment firm, Frontier Capital. Nathaniel, now 37, created his own hedge fund firm, Mangrove Partners, in 2010.

Being nurtured by two money managers didn't necessarily make August want to be a fund manager. He recalls his parents' silence at the dining room table one evening in October 1987, after the market fell by nearly 25% earlier in the day. "I don't believe I was thinking of a life in stocks at that time," August says.

Perhaps nature took over at that point. After he graduated from Brown University, he was accepted into Goldman Sachs' two-year analyst-training program and realized he shared his parents' passion for investing. His firm, which claimed the No. 36 spot on *Barron's* Penta's Top 100 Hedge Fund ranking this year, is named for a tree that can thrive in the most unforgiving environments.

"What I really like about the work," says August, "is the diversity—constantly moving across various industries, asset classes, and borders." This explains his wide-ranging, opportunistic strategy, which includes equity long/short, and what he calls "hard catalyst," or event-driven, investments, including merger arbitrage and liquidations, stressed and distressed debt, and capital-structure arbitrage. He and his team of six analysts can invest pretty much anywhere and aim for a market-neutral portfolio.

But what really drives August is the challenge of pulling the trigger on an opportunity. "Information is always incomplete," he says. "The thrill is bridging the gap between the known and unknown when making a decision."

Most compelling are market dislocations.

One example was the big selloff in municipal bonds after Wall Street analyst Meredith Whitney predicted widespread defaults in the tax-exempt sector in December 2010. By early 2011, Mangrove had 20% of its portfolio in seven muni bonds backed by industrial revenues. Within a few months, August's New York-based firm had sold virtually all of them, which helped boost his fund's return by 2.4 percentage points.

In the third quarter of last year, August realized that U.S. government policies to discourage companies from buying foreign rivals to take advantage of more generous tax regimes were affecting merger arbitrage spreads. Concerns that deals would collapse spiked annualized spreads (the gap between current market price and the projected closing price) from 5% to 10% out to 30% or more, recalls August. "We thought the market was overreacting."

August and his researchers believed that these new rules against tax inversions wouldn't have a big effect on projected tax savings. And to further reduce investment risk, he focused on deals that would be highly accretive to the buyers. In August 2014, Mangrove bought shares of Irish medical-device maker Covidien and shorted its proposed acquirer, **Medtronic** (ticker: MDT). The deal closed in January, and Medtronic is now headquartered in Dublin.

As spreads have returned to normal levels Mangrove has retreated, having added several percentage points to his fund's value.

These incremental gains have added up. Since the fund's launch in April 2010, it has returned more than 28% a year with relatively subdued volatility. Mangrove, which typically has 100 to 150 positions, has never had more than three consecutive down months. In early 2011, for example, August thought stocks had gotten ahead of themselves, seeing more short opportunities than long. While the average hedge fund lost 5.5% that year, Mangrove turned in a neat 22% gain, in large part because its portfolio isn't closely correlated to stock performance.

The numbers have propelled Mangrove's assets from \$7 million to \$450 million, and allowed it to charge 2% management and 20% performance fees.

The firm has been able to perform well in different conditions by limiting losses. First, Mangrove focuses on undervalued shares that often have fallen prior to their purchase. Second, at least to date, his timing has been very good. Third, the fund is market neutral with net long or short exposure typically limited to 10%, though it can be more. And finally, August periodically closes the fund to ensure capacity is in sync with opportunities.

An example of his contrarian thinking was

his purchase of **American International Group** (AIG), the insurer at the heart of the financial crisis, which was mostly taken over by the U.S. government in 2008. Two years later, the stock soared on a complicated recapitalization plan that involved the issuance of 75 million warrants (expiring in 2021), which enabled existing investors to purchase new shares at \$45. The stock was then trading around \$39. By 2010's end, the stock had jumped to nearly \$60. But once the shares started trading without warrants in 2011's volatile market, they fell sharply. Mangrove started buying in the year's first half; late in 2011, the stock had sunk as low as \$20.

"We were intrigued by a stock selling at about 50% of book value," explains August.

Mangrove didn't expect AIG's core businesses to thrive, but was convinced it was solvent and undervalued. The stock was receiving a boost from the disposal of more than \$50 billion in noncore assets, \$15 billion in share buybacks, and improved market conditions in 2012. By the first half of 2014, Mangrove exited at an average price of \$47, versus its average cost of \$33.60.

Reflecting the firm's "go anywhere" style, Mangrove two years ago discovered a distressed-debt play through one of its foreign brokers. It resulted in a \$20 million investment in the debt of Rubicon—a private Singapore-based owner of two floating production facilities for offshore oilfields in Southeast Asia. The company had already been restructured twice. But August saw the first-lien bonds as a "can't lose" opportunity when he purchased them in June 2013 at \$95, with a current yield of 15%, maturing in a year.

"We were actually hoping for a default," he says. That would have given Mangrove a substantial equity stake and a chance to reorganize the company. August estimated the firm's value to be twice the \$100 million bond issue—Rubicon's only debt.

Rubicon's management also recognized the value and repaid the debt—albeit two months late. Mangrove earned a total return of 20% plus a late payment charge worth 1%.

Mangrove has had a successful record of shorting biotech shares, though it doesn't always win. August believed **Heron Therapeutics** (HRTX) had set its goals too high this past May during Phase 3 testing of a drug, called Sustol, designed to treat chemotherapy-induced nausea and vomiting. Test results, however, turned out positive—good news for chemo patients, but not so much for Mangrove. It covered at a loss.

What's next? August thinks portions of Puerto Rico's \$72 billion in distressed debt may offer some opportunities because the complexity of various bond issues will probably lead to mispricings and dislocations. Like the trees that inspired his firm's name, his goal is to thrive in tough environments. ■

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BEST			% Returns			Assets	
	June	YTD	1-Year	3-Yr Cum.	5-Yr Cum.	(mil)	Strategy
ShadowHawk Fuxing 2	41.5%	99.8%	103.3%	N/A	N/A	N/A	Global Macro
Baker Street Capital Partners LP	19.3	9.5	-0.7	28.0	162.2	N/A	US Sm Cap Lg/Short Eq
CITIC Milestone View Trust 8	14.0	16.3	16.1	N/A	N/A	N/A	Eq Market Neutral
Pantera Bitcoin Fund Ltd	13.6	-18.4	-59.8	N/A	N/A	N/A	Lg-Only Other
Vol Edge B	12.8	-37.0	-35.9	-98.5	-99.8	8.7	Volatility
FOTIC DeJin 4 Quantification	12.7	32.5	N/A	N/A	N/A	N/A	Eq Market Neutral
Rudolf Wolff Global Eq Fd EUR	12.2	20.2	1.4	N/A	N/A	N/A	Global Lg/Short Eq
Quantitative Global Fund (3X)	11.8	33.6	8.4	-25.7	26.2	N/A	Systematic Futures
Vol Edge A	11.3	-31.4	-21.3	-98.2	-99.8	4.1	Volatility
Rudolf Wolff Global Eq Fd USD	11.2	19.0	0.2	N/A	N/A	N/A	Global Lg/Short Eq
WORST							
CFPI IQS Fund	-26.9	-29.1	-3.0	-60.8	-68.8	15.0	Systematic Futures
Efficient Diversified Fd SPC CI M	-19.2	-16.5	38.5	29.4	N/A	N/A	Fd of Fds - Macro/Sys
Fotic Mingshen 1	-17.5	-3.6	-9.3	N/A	N/A	N/A	Eq Market Neutral
Superfund Green Gold C (SPC)	-15.9	-8.8	1.3	-23.3	-13.0	11.8	Systematic Futures
Aria Select Consumer Fund	-15.4	-47.5	-51.2	-43.5	-41.8	N/A	US Lg/Short Eq
CIIT Zun Fu 1 Quantitative Hedgd	-15.3	-8.3	51.0	N/A	N/A	N/A	Eq Market Neutral
Lege Artis Fund Class P USD	-15.2	-12.6	-10.8	6.6	15.7	N/A	Fund of Fds - Multistrat
Formula Growth GIBl Opporntnts	-15.0	-1.6	-4.7	39.5	27.6	56.7	Global Lg/Short Eq
Bocommtrust Pingan Rus MOM 1	-14.6	26.3	48.8	N/A	N/A	N/A	Fd of Fds - Multistrat
Superfund Green Master	-14.6	-4.3	23.7	26.8	34.2	4.4	Systematic Futures
BIGGEST							
Bridgewatr Pure Alpha Strat 18% Vol	-4.0	10.3	6.0	26.2	87.7	31349.0	Global Macro
Millennium International Ltd	1.0	7.2	15.8	41.1	72.9	18309.0	Multistrategy
Bridgewatr Pure Alpha Strat 12% Vol	-2.6	6.9	4.3	17.3	52.5	9630.0	Global Macro
Millennium USA LP Fund	1.0	7.5	16.4	42.6	75.8	8074.0	Multistrategy
Bridgewatr All Weather 12% Strat	-3.8	0.6	-1.8	12.3	59.8	7737.0	Global Macro
Renaissance Inst Diversifd Alpha	-3.3	-3.2	11.4	14.7	N/A	4973.2	Multistrategy
UBS (CH) IF Eqs CHE Pass All IX	-4.9	0.7	5.5	58.4	65.1	2859.1	Lg-Only Eq
Baring Dyn Asset Alloc I GBP	-2.8	3.7	7.0	20.3	37.2	2408.8	Multistrategy
MKP Credit Offshore Ltd	-1.4	2.0	1.4	38.0	47.9	2262.0	Lg/Short Debt
MKP Opportunity Offshore Ltd	-1.0	4.9	8.1	13.0	31.1	2239.0	Global Macro
Pinnacle Natural Resources LP	-2.2	-6.7	2.4	4.3	26.3	2026.0	Fd of Fds - Macro/Sys
Alphadyne Int'l Master Ltd	0.7	4.5	12.1	22.1	36.2	1925.0	Multistrategy
BlackRock Obsidian Offshore	-1.5	1.0	-1.0	31.4	61.5	1900.0	Debt Arbitrage
BlackRock Obsidian Onshore	-1.5	1.0	-1.0	31.5	57.3	1900.0	Debt Arbitrage
STS Partners Fund	0.3	8.9	18.9	98.3	215.2	1600.0	Distressed Securities
SCS Capital Partners, LLC	-1.2	0.9	2.9	24.1	28.8	1579.8	Fund of Fds - Multistrat
ECF Value Fund II LP	-1.8	-0.1	-7.1	29.3	90.7	1575.4	Event Driven
Efficient Diversifd Fd SPC CI S	-9.7	-7.7	18.4	16.6	5.6	1574.0	Fd of Fds - Macro/Sys
Babson Cap Euro Loan B EUR Acc	-0.3	4.0	4.6	24.6	N/A	1479.0	Lg/Short Debt
Babson Cap Global Loan C AUD	-0.2	2.6	1.5	10.7	N/A	1471.3	Lg/Short Debt

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