THE DEAL DOCTOR

CORPORATE RAIDER **MARK RACHESKY**

BEAT HIS MENTOR **CARL ICAHN**

IN A BATTLE FOR CONTROL OF **LIONS GATE**.

NOW, THE PAIR ARE SIDE BY SIDE IN AN

ATTACK ON **NAVISTAR**, AS ACTIVIST

CAMPAIGNS ESCALATE

TO 2008 LEVELS.

BY ANTHONY EFFINGER

When hedge-fund investor Mark Rachesky faced off against Carl Icahn in a battle for Lions Gate Entertainment Corp., he knew his adversary well. Rachesky, a Stanford University M.D. who's never practiced, had worked for Icahn for six years until 1996. Then he left to start his own company: MHR Fund Management LLC. Master and apprentice met again in 2008, when Icahn, a relentless corporate raider, built a 9.2 percent stake in Lions Gate. Rachesky already owned 15 percent.

Icahn tried to force out Lions Gate's leaders, calling them profligate spenders. Rachesky stuck by them, and together, they fended off the threat with a crafty debt-for-equity swap. Icahn sued his protege, calling the transaction—in which Rachesky bought convertible bonds from another investor and immediately turned them into stock—a sham.

Icahn lost in court in November 2010, and 10 months later, he agreed to sell his Lions Gate shares for $7, a dime more than the average price at which he had accumulated them. Lions Gate shares closed at $19.74 on Feb. 11, lifted by the dystopian blockbuster film *The Hunger Games* and *Warm Bodies*, a comic zombie-human romance. MHR—Rachesky's initials—owns 51 million of them, or 35 percent of the company.

Now, Icahn, 77, and Rachesky, 54, are back at it, building stakes in struggling truckmaker Navistar International Corp. Each has about 12 million shares. So far, there are no lawsuits.

"These guys are deal-fight junkies, and they have a taste for each other's blood," says Matt Harrigan, an analyst at Wunderlich Securities Inc., in Denver, who follows Lions Gate. When it comes to getting control of companies, Rachesky is like a brawler in the few-holds-barred Ultimate Fighting Championship circuit, Harrigan says. "He's a superbright guy, and he's well versed in UFC tactics in these fights," he says.

Rachesky and Icahn are activist investors. They don't buy a stock, dial into earnings calls and hope for the best. They take a stake and angle for control. Rachesky has succeeded in elevating himself to chairman of four corporate boards: Lions Gate; Loral Space & Communications Inc.; Telesat Holdings Inc., a satellite-communications-network operator majority-owned by Loral; and Leap Wireless International Inc.

Icahn, Rachesky and agitators like them launched 219 campaigns in 2012, a 22 percent increase from 2011 and the most since 2008, according to FactSet Research Systems Inc. in Norwalk, Connecticut.

One of the nastier fights came to a head in May, when Daniel Loeb, founder of hedge fund Third Point LLC, got Yahoo! Inc. chief executive officer Scott Thompson booted by flagging discrepancies in Thompson's resume. In June, Bill Ackman's Pershing Square Capital Management LP forced out Canadian Pacific Railway Ltd. CEO Fred Green. This year, he's gunning for Herbalife Ltd., calling the nutritional supplements maker a pyramid scheme, an allegation denied by Herbalife.

Rachesky managed more than

$5 billion in three funds as of late February, from offices 24 floors above West 57th Street in New York. MHR's biggest holdings are Lions Gate and Loral, both at about $1 billion as of mid-February.

Rachesky is raising money for a fourth fund, according to a person familiar with the matter. For the first time, he's doing it without co-founder Hal Goldstein, who left MHR last May. Spokeswoman Annabelle Rinehart wouldn't say why Rachesky and Goldstein, 47, split. Goldstein, a lawyer by training, says he has no comment on the matter. Rachesky, says Rinehart, doesn't do interviews.

Rachesky's hardball tactics get results for his investors. His first fund raised $217 million in 1998 and has posted an annualized return of 16 percent after fees as of Sept. 30, according to a November confidential investor presentation obtained by BLOOMBERG MARKETS. The second fund, an $856 million pool from 2003, returned 13 percent a year as of Sept. 30. Fund III, started in 2007 with $3.5 billion, has an 8 percent return. According to the presentation, MHR has completed 43 major investments in its 16-year history, and 39 have been profitable.

MHR has invested in medical companies, as one would expect from a doctor turned raider. One, Emisphere Technologies Inc., is working on the oral delivery of drugs that are now injected. It's one of Rachesky's few stinkers. As of Feb. 11, its stock was down 96 percent since he joined the board in 2005.

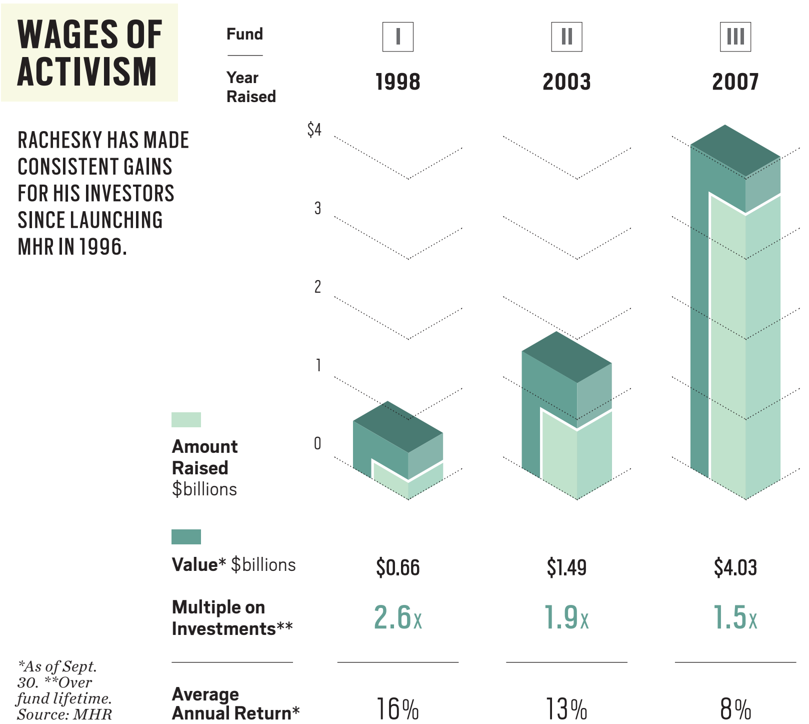
Mostly, though, Rachesky likes to buy companies that make hard assets—satellites, trucks, films—and he likes to get them cheap. He buys stock after a fall, or he scoops up debt for pennies on the dollar. In 2010, Rachesky formed a company called Archway Aviation Inc. to take advantage of what the presentation called "distress" in the jetliner-leasing market. Archway owned seven aircraft as of November and was working on a "highly complex" purchase of two more, the document says.

"Mark is a financial mercenary," says Michael Burns, vice chairman of Lions Gate, who allied with Rachesky to fend off the attack by Icahn. "He will invest anywhere he thinks there is opportunity." Rachesky does his own analysis, too. "Mark digs into the nitty-gritty. He's wicked smart," Burns says.

Rachesky lives among some of the wealthiest people in the world, in a ninth-floor duplex apartment on Fifth Avenue, across from the Central Park

Rachesky and his wife, **Jill**, opposite, and **Carl Icahn** and his wife, **Gail**, below, attend New York social events. The younger dealmaker defeated his mentor in a battle over **Lions Gate**, whose stock has jumped since it released ***The Hunger Games***.

PREVIOUS SPREAD, CLOCKWISE FROM LEFT: COURTESY OF MARK RACHESKY; CHAD BATKA/THE NEW YORK TIMES/REDUX; COURTESY OF LIONSGATE; PRNEWSFOTO/NAVISTAR/AP; THIS SPREAD, CLOCKWISE FROM LEFT: PATRICKMCMULLEN.COM; COURTESY OF LIONSGATE; GARY GERSHOFF/WIREIMAGE/GETTY IMAGES



Zoo. He and his wife, Jill, bought the place for $33.4 million in 2007. Rupert Murdoch, chairman of News Corp., also owns an apartment in the 1930s limestone edifice, as does mutual-fund magnate Charles Schwab.

The Racheskys also have a beachfront place on Gin Lane in Southampton, New York, that they bought for $14.4 million in 2004. An aerial view on Google Maps shows a tennis court, a pool and a putting green flanked by sand traps.

Rachesky has an unusual background for a corporate raider. He grew up in Clifton, New Jersey, and graduated from the University of Pennsylvania in 1981 with a bachelor's degree in "molecular aspects of cancer." He went west to Stanford University and got both an M.D. and a Master of Business Administration in 1987. The MBA won out, and after graduation he went to work for Texas buyout billionaire Robert Bass before joining Icahn's shop in 1990.

When he's not raiding corporations, Rachesky likes spending time with his wife and four children, a person who knows him says. He has a sweet tooth and loves jelly beans. He works out every day, usually by running.

In business, Rachesky is maniacal about research, says Tariq Fancy, who worked at MHR for five years until 2008. When he is interested in a company, MHR staffers interrogate competitors and visit trade shows trying to determine if a struggling firm can recover, Fancy says. "You get to know a company inside and out, then take a big position," he says. Despite his high-powered academic degrees, Rachesky has street smarts, Fancy says: "He's a very good negotiator. No one is going to get one past him."

Navistar is Rachesky's latest target, and also Icahn's. So far, two isn't a crowd. "Their visions don't clash on Navistar," says Andrew Rossman, a long-time lawyer for Rachesky. The two men talk, he says. "I think Mark would say that Carl is a very savvy investor." Icahn didn't return calls on the matter.

Navistar traces its roots to a mechanical grain harvester invented in 1831. These days, it makes heavy trucks and buses. The company became vulture bait after it spent $600 million from 2000 to 2011 to design new low-emission engines, which then failed to meet government standards. Sales slowed, and investors bailed. In 2011, its stock fell from $70.17 on April 26 to $37.88 at year-end.

Icahn disclosed his stake in October 2011. Rachesky invested in May 2012. In September, Icahn wrote a public letter to Navistar demanding seats on the board. Navistar "has become a poster child for abysmal business decisions and poor corporate governance," Icahn wrote. In October, Navistar gave his firm a seat, also added Rachesky and promised to add a third person approved by both investors.

When Rachesky makes a mistake, it's by waiting too long to sell. He's controlled San Diego–based Leap Wireless since it emerged from bankruptcy in 2004. In September 2007, Richardson, Texas–based MetroPCS Communications Inc. offered to buy Leap for $5.5 billion, or $77.89 a share, payable in MetroPCS shares. Leap's board, with Rachesky as chairman, turned down the offer. Leap shares have been falling ever since; they sold for $6.02 on Feb. 11. As of Sept. 30, MHR's Fund III had lost 60

RACHESKY, ICAHN AND THEIR ACTIVIST ILK LAUNCHED 219 CAMPAIGNS IN 2012, A 22 PERCENT INCREASE FROM 2011 AND THE MOST SINCE 2008.

percent of the $208 million it invested, the presentation says.

Loral, by contrast, has been one of Rachesky's best investments. He's almost tripled his investors' money in Fund III so far, according to the confidential presentation. The win wasn't pretty, though.

Loral, a New York–based maker and operator of satellites, fell on hard times after the dot-com bust of 2000, along with other space-communications ventures. Iridium LLC and Teledesic LLC collapsed. Loral fell more than $3 billion into debt.

Rachesky spotted an opportunity and tapped Michael Targoff, who had worked at Loral for 16 years until 1998, to help him research the investment. In 2001, MHR bought Loral bonds with a face value of $613 million for 20 cents on the dollar, according to a research report by Susan White, a teaching fellow at the University of Maryland. Loral declared bankruptcy in 2003. The debt held by MHR became equity during the reorganization, making Rachesky the largest shareholder, with 36 percent. He was named chairman in February 2006, 10 weeks after Loral emerged from Chapter 11.

Soon after, Rachesky sought to boost MHR's stake to 57 percent by buying $300 million of Loral preferred stock. As both Loral's chairman and the head of MHR, he had authority over both entities. Moreover, three of Loral's eight board members were MHR executives, and two others had ties to the firm. Loral set up a special two-person committee of the board to evaluate MHR's bid.

MHR MADE $240 MILLION VIA A 2012 TELESAT DIVIDEND AND ANOTHER $512 MILLION ON THE SALE OF LORAL'S SATELLITE-MANUFACTURING UNIT.

Rachesky wasn't on the committee, of course, but his old friend from Stanford University, John Harkey, was, according to an opinion on the deal written by Delaware Chancery Court Judge Leo Strine in September 2008.

Harkey, 52, is a man of many enterprises. The Stanford MBA is chairman and CEO of Consolidated Restaurant Operations Inc. in Dallas, owner of restaurant chains El Chico Cafe and Cool River Cafe, among others. He also cofounded a company called BioLife Cell Bank in Dallas that stores stem-cell–rich tissue removed in liposuction to be used later for breast augmentation and face-lifts.

The other committee member was Arthur Simon, an accountant who had retired from Coopers & Lybrand LLP in 1994.

Targoff, by now CEO of Loral, told Harkey that the company needed the $300 million as soon as possible. Harkey hired boutique investment bank North Point Advisors. Its head was attorney David Jacquin. Neither Jacquin nor North Point had any experience with satellites, and Jacquin had little experience with convertible preferred stock, Strine wrote. "The special committee chose a financial adviser that was not qualified to swim in the deep end," Strine wrote.

North Point determined that MHR was the best investor to tap for $300 million. The problem: "North Point did not contact any third parties about the Loral financing before its June 4 presentation," Strine wrote. "NONE."

Rachesky, Targoff and Harkey were "chummy" during the negotiations, Strine wrote. At one point, Harkey even pitched MHR on another investment, proposing to an MHR analyst that the firm put $30 million into Joe's Crab Shack, a chain of restaurants that Harkey was trying to buy, Strine wrote.

Simon, the only other member of the special committee, was out of the loop, Strine wrote. In the midst of negotiations, Simon left to camp on a remote lake with no electricity for a month.

SPACE SHOT: MHR'S LUCRATIVE LORAL TAKEOVER

MAY 2001
MHR makes its first investment in Loral, buying company bonds with a face value of $613 million for 20 cents on the dollar.

JULY 2003
Loral files for bankruptcy. MHR, the largest holder of its debt, is chosen to head the creditors committee.

NOVEMBER 2005
Loral emerges from bankruptcy. MHR's debt is swapped for equity, making it the largest shareholder with a $200 million stake. **Rachesky** is named chairman of Loral 10 weeks later.

FEBRUARY 2007
Loral sells $300 million of preferred stock to **MHR** in a deal that a Delaware judge later says was unfair to Loral. The sale raises MHR's stake to 57 percent.

MARCH 2012
Loral subsidiary **Telesat** borrows $2.5 billion and makes a distribution to Loral, which uses it to pay a $13.60-per-share dividend. MHR collects $240 million.

NOVEMBER 2012
Loral sells its satellite-manufacturing unit for $968 million and declares a $29-per-share dividend, which pays MHR $512 million. MHR tells investors in **MHR Fund III** it has almost tripled its money on Loral.

Sources: MHR, Delaware Court of Chancery, Susan White, Bloomberg News

"Simon took a 6-mile boat trip for 'a couple of telephone meetings' during that time," Strine wrote.

Simon declined to comment on the matter.

Loral announced plans for the $300 million financing on Oct. 17, 2006, less than a month before Loral posted a 42 percent increase in quarterly sales, to $227 million.

Shareholders, including Jim Dondero, the big game–hunting Texan who runs Highland Capital Management LP, immediately wrote letters questioning the deal's fairness. Highland told Loral that it would invest $300 million on terms better than MHR's.

Harkey and Simon never followed up on the offer, and on Feb. 27, 2007, Loral completed the preferred share sale to MHR. Loral shares opened at $49.70 that day. MHR had the right to buy them at $30.15. The result: an immediate paper profit of $195 million for MHR. In addition, Loral agreed to pay MHR a $6.8 million placement fee for the financing, according to a Loral government filing.

After an 18-month legal brawl, Strine ruled that MHR's financing was unfair to Loral. "Using its effective control, MHR set in motion a process in which the only option that the special committee considered was a deal with MHR itself," Strine wrote.

The judge's remedy was to make MHR amend the terms of the financing so that it no longer got preferred shares that had voting rights but, rather, nonvoting common stock, a move that cut Rachesky's voting rights to 36 percent even though MHR owns 57 percent of the common stock. Strine also rescinded the $6.8 million placement fee. MHR didn't appeal. The control freak had to accept less control.

That legal entanglement aside, Rachesky has improved the bottom line at Loral. The company earned $127 million in 2011, the last year for which figures are available, compared with losses of $15 million in 2007 and $23 million in 2006.

Truckmaker **Navistar** became vulture bait when its low-emission engines failed to meet government standards.

MARK ELIAS/BLOOMBERG

Lately, Rachesky has been cashing out of Loral. In March 2012, Loral subsidiary Telesat borrowed $2.5 billion and then made a distribution to Loral. Loral, in turn, paid its shareholders a whopping $13.60 per share from that cash. MHR got $240 million.

In November, Loral sold its satellite-manufacturing business to MacDonald Dettwiler & Associates Ltd., a Canadian satellite company, for $968 million. Loral used the money to pay a $29-per-share dividend. MHR collected $512 million on that payout.

Now, most of what remains of Loral is its 64 percent stake in Telesat. Canada's Public Sector Pension Investment Board owns the rest. Loral plans to unload Telesat through a sale or public offering, according to the MHR investor presentation.

So far, trucks are proving less lucrative than satellites for Rachesky. MHR has purchased Navistar shares at prices from $18.75 to $29.32, according to filings with the U.S. Securities and Exchange Commission. They sold for $26.07 on Feb. 11.

If history is any guide, however, Rachesky is just getting started with Navistar. He's not chairman yet. If that happens, dividends are likely to flow to his investors. Control, for Rachesky, is money.

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BATTLE OF THE ACTIVISTS

To see the biggest holders of Navistar International, type **NAV US <Equity> HDS <Go>** on the Bloomberg Professional service. Tab in to the TEXT SEARCH field, enter *MHR* and press <Go> to see how many shares of the company Mark Rachesky's firm holds. Then type **CAST <Go>** to see Navistar's capital structure. Type **HFND <Go>** for the Hedge Fund home page. For a complimentary weekly newsletter on Hedge Funds, type **BRIEF <Go>** and click on the box next to Subscribe under Hedge Funds. For headlines of news stories about hedge funds, type **NI HEDGE <Go>**. **RICK LEVINSON**