Forbes / Investing

JUL 29, 2015 @ 06:00 AM 37,518

Meet Patrick Walsh, The Do-It-Yourself Hedge Fund Activist You've Never Heard Of

Unheralded hedge fund activist Patrick Walsh has found the right recipe when it comes to betting on the turnaround of struggling restaurant chains. (David Yellen For Forbes)

Antoine Gara, FORBES STAFF

FULL BIO

This story appears in the August 17, 2015 issue of Forbes. Subscribe

In the increasingly crowded world of flashy activist hedge fund managers, Patrick Walsh, 39, plays against type. The founder of the $150 million PW Partners in Chicago wasn't schooled at Wharton and has no Ivy League pedigree or M.B.A. He didn't apprentice with hedge fund greats like Carl Icahn, Dan Loeb or Bill Ackman, and he eschews the public spats that make activists a favorite of the news media. He's got no public relations handler or even an in-house trader to execute his stock moves.

Walsh is a DIY activist. When he targets a new company, typically a restaurant where growth has petered out, his prescription isn't just financial engineering. He relishes the opportunity to roll up his sleeves and offer new ideas to management for cutting costs and improving operations.

That's why FORBES is riding shotgun with him in a white Honda Civic Zipcar along 52nd Street in New York. We've just returned from a visit to one of his targets, a recently opened BJ's Restaurant & Brewhouse in Nanuet, N.Y. Walsh is dawdling through Manhattan engrossed in a discussion of investing strategy. A crimson GMC van starts blaring its horn at our slow-moving vehicle. As the van driver pulls ahead from the right he pauses to shout profanities in Walsh's direction before speeding off toward Fifth Avenue. Walsh doesn't skip a beat. "I think you want to focus on per-share value," he says, without acknowledging the minor melee he created. "It's not about trying to build an empire for the sake of it."

At BJ's we had devoured a many-thousand-calorie lunch of craft lager (brewed on the premises), Santa Fe rolls, pizza with chicken and Alfredo sauce, and bacon cheeseburgers. Walsh was adamant about trying his favorite dessert: a Frisbee-shaped, 2-inch-deep concoction of baked marshmallow fluff, chocolate chip cookie and ice cream called a "Pizookie," which he was unable to finish.

The feast was designed to give insight into one of Walsh's top-performing investments, the quick turnaround of California-based BJ's Restaurants BJRI +0.22%. Walsh is on the board of the Huntington Beach company, an expanding chain of 159 restaurants with $845 million in annual revenues. He bought a 5% stake at an average price of $30.41 a share in early 2014, after BJ's growth had slowed, exposing operational inefficiencies that cut into margins. Then he approached management with a cost-saving plan endorsed by fellow activist fund Luxor Capital in New York City.

BJ's CEO, Greg Trojan, says Walsh's attention to detail and lack of ego won him over. "There's a brand of folks who always think they are the smartest guy in the room," he says with a heavy-handed reference to most Wall Streeters. "Patrick is not in that category."

Initially Walsh raised concern about BJ's marketing spending, which nearly doubled to $17 million in 2013 even as same-store sales fell 1% and profits 33%. It was part of a process to simplify BJ's menu and improve kitchen efficiency through the rollout of its Brewhouse Burger, a 5-ounce patty with extravagant toppings selling for less than $10. Walsh became convinced that Trojan's new streamlined-menu strategy would speed up kitchen turnaround times, and he dropped his concerns. Marketing rose to $19.5 million in 2014.

"It gave me great comfort even early on that he was thoughtful and would listen," says Trojan, who attributes much of BJ's $150 million share repurchase program to Walsh's advice, and further credits the activist with giving focus to a cost-saving plan, which increased restaurant margins.

BJ's shares now trade at $50, up 55% since Walsh took a seat on the board in June 2014. In the first half of 2015 revenues increased 7.5%, and margins gained 230 basis points, helping to nearly double earnings per share.

BJ's isn't the only restaurant where Walsh has made a big mark.

In 2010 he led a group that built a 7% stake in Denny's and narrowly lost a proxy war to change management. Walsh cashed out after a bruising fight, with gains of more than 50% in under a year. He then targeted Red Robin Gourmet Burgers, building a 13.5% stake and negotiating a board seat in 2011. He uncovered $20 million in savings and exited up nearly 80% in under a year. Great trades for Walsh, but he learned a hard lesson about leaving money on the table. Denny's stock has quadrupled and Red Robin's has nearly tripled since he sold out.

Famous Dave's of America has doubled since Walsh took a 10% stake in late 2012. In his first year as a director operating cash flow rose 66%. Trading profits have been stellar--he sold 45% of his stake in June for a 280% gain--but he's hanging on to the rest. Says Walsh: "The big money is made over the long term. I realized that with Red Robin."

Once he's inside the boardroom, Walsh's playbook calls for finding small savings that add up--from turning air conditioners off at night to changing trash pickup schedules and simplifying menu items. At Red Robin it was about buying whole avocados, instead of pre-sliced, and then slicing them in-store. For BJ's, he found savings across nonfood items like trash bags, tablecloths and dishwasher fluid.

As a BJ's board member he eats for free at the company's restaurants and takes his wife and three young daughters to BJ's as much as possible to gauge store traffic and chat with employees. He will even ring CEO Trojan, alarmed, if waiters don't try to sell him or his kids the Pizookie dessert.

Given Walsh's relatively small size among activist hedge funds, he has deftly formed alliances with larger and more prominent players. In addition to Luxor, Walsh worked with New York's $2 billion HG Vora in 2012 when he challenged Apollo Global's $5-a-share buyout offer for Great Wolf Resorts of Madison, Wis., an operator of water parks and hotels. The private equity giant's eventual offer of $7.85 earned an 80% return for Walsh and company in a matter of months. In his latest investment, in Del Taco of Lake Forest, Calif., Walsh raised tens of millions of dollars from various funds after Larry Levy, a Chicago restaurant and food-service maven, tapped him to help buy control of the promising Mexican fast-food chain. His fund is already up 80%, before fees.

Since he formed PW Partners in 2012 the only portfolio loss Walsh has had is a 10% stake in Town Sports International, the parent company of the New York Sports Clubs, which he purchased in August 2014. NYSC continues to struggle to compete with Planet Fitness and SoulCycle, and shares are down 60% so far this year. But Walsh recently won a shareholder campaign alongside established funds like Farallon Capital to replace its board. In June he was named executive chairman.

The son of an accounting partner at KPMG and a homemaker, Walsh grew up in Foxboro, Mass. His interest in investing stems from a fateful elevator ride with Warren Buffett in 1995 as a 19-year-old summer intern in the accounting department of Gillette .

Buffett was on Gillette's board, but the Oracle of Omaha wasn't on Walsh's radar. A colleague had to tell him he'd ridden with America's greatest living investor. Intrigued, Walsh bought Roger Lowenstein's Buffett biography, The Making of an American Capitalist, and quickly became obsessed. He's read every Berkshire Hathaway BRK.B +0% annual report and become a regular at the company's shareholder meetings, even dragging his wife along.

The elevator ride also caused Walsh to plot out a methodical path into money management, with the goal of venturing out on his own. After graduating from Boston College in 1998 with a degree in accounting, Walsh did a three-year stint in Atlanta, where he worked in real estate private equity for Prudential Capital and earned a C.F.A. He then spent a half-dozen years on Wall Street, first as an analyst of REIT and lodging stocks before moving into investment banking at Deutsche Bank , where he rose to vice president and worked on the $39 billion buyout of Equity Office Properties.

Without any blue-blood connections, Walsh used a strong work ethic and an affinity for sweating the financial details to make himself a "go-to guy" on complex deals, says Devin Murphy, former head of Deutsche Bank's real estate investment banking group. But Walsh's true passion was investing.

So in February 2008 Walsh cashed his $400,000 bonus check and took an 80% pay cut to join Chicago-based hedge fund Oak Street Capital to begin building an investing track record. Within a few years he was running his first activist deals, leading to Denny's in early 2010 and then to Red Robin.

With a number of winning deals in his quiver and a growing family at home, Walsh formed PW Partners four years later in 2012 with $1 million in savings as well as money from friends, colleagues and investors.

Like most other hedge funders, Walsh thrives on gaining intimate knowledge of his targets and is obsessive about finding companies he feels are cheap on a cash-flow basis. Most of his $150 million in assets comes from the appreciation of his investments. He is currently on a quest to get bigger fast, in part because hedge funds of $1 billion or less barely make the radars of most institutional investors. He recently hired a COO and expects to hire one analyst this summer.

Despite his initial successful run investing in restaurant stocks, Walsh knows he must expand beyond the proverbial kitchen. Town Sports, the owner of 158 sports clubs, will be a litmus test for Walsh as an activist-operator. After years of price cuts, the company has disappointed Wall Street with low membership growth and falling revenue. Competitors like discount gym Planet Fitness and niche players like SoulCycle and Blink are eating into its market share. "Traditional gyms left in the middle are finding it harder to compete," says analyst John O'Neil at Imperial Capital.

"I've met with 120 of our general managers over the past few weeks," says Walsh, who rattles off a list of marketing gaffes at the company, including the lack of any social media strategy.

"It's about empowering them. In the past they have been told what to do," says Walsh. "I am saying you are the individual CEO of your unit, and you should run it like a small business."

Walsh's words of encouragement shouldn't be confused for a new, hands-off approach. If his track record is any indication of what is in store for Town Sports, you can be sure that Walsh will be spending a good deal of time in the gym working off his Pizookies.

TRENDING

What the 70 million Forbes.com users are talking about. For a deeper dive go to

Forbes.com/investing