



IHS Markit Perspectives X (October 12th, 2020)

Shareholder activism during a global pandemic

IHS Markit's Perception Analytics team engages in in-depth discussions with investors and analysts daily. In light of market volatility and economic uncertainty, IHS Markit is speaking to investors and analysts on a regular basis to assess how the current situation with COVID-19 is impacting their evaluations of and engagement with corporate issuers.

As part of our series on the effects of COVID-19 on the capital markets we have examined market sentiment on the use of technology, IR communication, capital strategies, earnings call expectations, and ESG during the pandemic. **In our tenth installment, we ask market participants whether they believe shareholder activism should be seen differently in light of the current environment.** Activism has been featured in recent newspaper headlines, in some cases for pausing their campaigns while in others for continuing to agitate for change. As such, we thought it would be interesting to canvas investors and analysts to understand how their interactions with their own portfolio companies have been affected by activism.

Some investors and analysts note that activism plays a critical role in a free market and thus do not believe it should change depending on the market environment, especially if the focus remains on the long-term investment case.

- “We are not an activist. As of right now what you are going to see is gravediggers, for want of a better word. Some activists are going to go out and be very active in scooping up some beaten down stocks. QIA, the Qatari government, just bought 10% of Carnival. There are headlines of Chinese companies looking at European companies because they are down 40%, 50%, or 60%. Cash is king. There are going to be opportunities. There are going to be some losers. How does that play out? **In a capitalist world, you want to let the capital markets work. They work fabulously well.** The ECB, BOJ, and the Fed have all done an excellent job of providing liquidity. The banks in the US have been well capitalized. The markets have been extremely resilient, despite the 30-40% drop in equities, so the system has worked. But, if you get hostile takeovers coming in, there could be some nationalistic pushback. We have not seen that in a long time, but whether that is with an activist hedge fund or a sovereign, we are going to see that play out in the next 12-24 months. Some activists are good and some are not. It depends on what your perspective is. Some people think the activists are distasteful right now. There are good activists and bad activists. If companies are facing a hostile takeover, they should act in the best interest

of shareholders and not of the management team.” *Portfolio manager, US investment manager (\$1B EAUM)*

- “We generally take activist campaigns one at a time. We do engage in them and have remained active with some of our holding companies by trying to affect change in the Board structure. We are very active still. **Companies need to evaluate activists on a case-by-case basis.** If a hedge fund is just looking for short-term gains at the expense of long-term value creation, that would be an example of when a company should be fighting back. At the same time, there have been instances where the activists have made positive change. At the end of the day, our judgement on where we line up with any activists depends on if they are actually trying to improve the long-term returns of the company. We would embrace that.” *Portfolio manager, US investment manager (>\$20B EAUM)*
- “We do not participate in many activist campaigns. We like to dialogue with management teams and provide our input on subjects, but I am not sure if we have ever participated in traditional activism. **It seems like activists tend to target management teams that deserve a bit of a push. It is generally healthy.** As a management team, you should be open to what they have to say. That does not mean that activists are always right. They can be short-term oriented and just seeking a stock pop. An activist campaign probably has legs if there is a widespread perception that the management team has underperformed. It is healthy overall, but I am neither positive nor negative on the topic.” *Portfolio manager, US investment manager (>\$15B EAUM)*
- “Shareholder activism is always important, but it is not what is moving the share price in this environment. **If we agree with any campaign that improves the company’s ESG, we are always more than welcome to participate.** That is a consistent view regardless of COVID-19. Companies facing an activist need to evaluate who benefits at the end of the day. If it is a short-term investor that wants short-term gains at the expense of long-term growth, we would be against it. Activism that leads to a more sustainable and investor friendly company is worth supporting. We do not necessarily support actions like unbundling or big cash pay outs for short-term gain.” *Portfolio manager, UK investment manager (>\$90B EAUM)*
- “My view on activism has not really changed. We always are reluctant to attach ourselves to any sort of shareholder activism. We try to consistently give a message to companies that is independent of other investors. We will always vote consistently with the same message we have been presenting. We are never really influenced by what other activists might be doing in the market. **Sometimes activism is a good thing and brings issues to the forefront. It is needed sometimes.** When people say shareholder activism, some people tend to think of examples where investors go to the press and are very public. Activism for us can be very private. You do not need to shout everything from the rooftops. Sometimes that is more effective.” *Portfolio manager, South African investment manager (>\$2B EAUM)*
- “Fundamentally, our view on activism has not changed. COVID-19 has changed my opinion on companies I previously perceived as being too conservative and holding too much cash or inventory on their balance sheet. This is particularly relevant for Japanese companies. In hindsight, having a buffer for extreme events is something we have to reconsider when we engage with companies. The approach American companies have taken by raising debt to buy back shares looks foolish for several sectors now. Japanese companies accumulating tons of cash and never utilizing it used to look really ill-advised, but now it seems a bit wiser. There is

more nuance in how we will evaluate it going forward. Maybe we will challenge companies that run their businesses aggressively in the future. That being said, we will continue to push companies to be more efficient where we think it is still prudent to do so. We are monitoring how companies are responding to this environment. Some companies are being very responsible and not trying to take advantage of the situation while others are just going into self-preservation. This is unsustainable once we get out of the crisis and may have repercussions. We will not stop activist campaigns. **Challenging companies on how they run their businesses is part of our job.** There are different forms of activism. We try to be quite constructive and present what we think are good initiatives for management. It is always in management's interest to at least engage in the dialogue. They can then decide if they agree with the advice. Management has more to gain than lose by engaging in these discussions. Obviously, there are some activists who are more PR-driven and drive their engagement through media or superficial analysis. The best weapon against those is to present information to investors to make it very clear how the business works. That makes companies less vulnerable to attacks." *Analyst, UK investment manager (>\$80B EAUM)*

- "I differentiate between shareholder activism and short sellers. Sometimes short sellers suggest that they are activist, but they really are not. There have been some companies who have been hurt by short sellers that completely disrupt share prices and can sour investors' views. Sometimes they are useful like with Luckin Coffee. Other times, they are just plain wrong. **I do not think there is anything indecent about activism regardless of the circumstances.** There is really a difference between the competent short sellers, competent activists, and the others." *Analyst, European investment manager (\$10B EAUM)*

A few investors and analysts assert that the current market volatility specifically provides a unique advantage for activist activity.

- "**Activists are doing what they have to do.** Activists like Bill Ackman are protecting their capital for their investors. They are trying to benefit from a unique situation. Nothing needs to change in light of COVID-19. This can be a good opportunity for them and their investors." *Portfolio manager, South American investment manager*
- "Some companies have instituted poison pills as a precaution against takeovers. We enacted an activist campaign ourselves a couple weeks ago. It was unaffected by COVID-19. It was in regard to the economics of the underlying entity. It has more to do with the companies that are cheap versus expensive. There is a bit more tension. There has been very narrow valuation dispersion for several years, but now some energy companies are down 90% while some Chinese companies are flat. **There is a lot more valuation spread, which incentivizes activism.** Companies are always hesitant. The opportunity has increased and resulted in more companies being resistant to it. A lot of companies tend to politicize activism. People will defend their own tribe. You hope that people are incentivized to create the most wealth for everyone. The incentive structure needs to be aligned with long-term wealth creation instead of short-term stock price movement. You want more focus on ROIC." *Analyst, US investment manager (>\$40B EAUM)*

- “Clearly, there has been a move towards ESG. **There is a very a strong correlation with ESG scorecards and more engagement with vested interests. Activism is clearly an expression of that.** With COVID-19, activism has been driven on a few levels as it relates to social, environment, and governance scores. For example, look at the price of oil and how that has collapsed and has led to failures in the system. One could question why ESG has not done enough to prevent these issues from coming back again? Many of the issues in the financial system that we saw in the global financial crisis are reoccurring. The question is, has management or corporates really changed and reacted in a more ESG-friendly manner? Sadly, this crisis has shown that perhaps the questions that were asked were not asked properly. Therefore, we need to think about a better way to engage and how activism is done. It comes down to transparency and greater engagement in activism. I believe that activism will continue to grow and there could be greater onus on investors to step up our game of being more critical of companies that do the wrong thing. I believe that activism is going to be done in a more smart and structured manner as opposed to ESG simply meaning that a company cannot invest in coal, tobacco etc. To me, activism is not about taking a view on ethics but rather creating value for shareholders.” *Portfolio manager, APAC investment manager (\$1B EAUM)*

However, many investors and analysts suggest that activism should be put on hold given the volatility and uncertainty at the moment.

- “I feel it is best to keep the shareholder activism on hold at this moment. This is because no one knows what is going on in this time of crisis. **Instead of shareholders telling companies what to do, it is better to just let the companies do their job.** The companies are much more involved in the day to day running of the business, so they should have a much better sense of what to do than we as the investment community have. This is especially important as this crisis changes every minute, every day.” *Research senior associate, South American sell-side firm*
- “We are an active investor and an activist investor. **We think that activists play a part in some regards in the market. I think it is the right time for them to take a pause.** There are businesses across sectors that are going to struggle in the short- and medium-term for sure and having an activist pushing for a strategy change at this particular time is not going to be helpful. We need companies to be focused on the longer term and how their business is stable.” *Analyst, UK investment manager (>\$90B EAUM)*
- “In light of the current environment, activists should definitely reconsider taking action against companies. **Right now, it does not make sense for a company to waste cash when there is a big liquidity concern and sales are going down a significant amount.** Right now, having a strong balance sheet is better. What activists were previously saying might not make sense. A big question is being posed. Obviously, if the share price is weak one idea might be to give the shares to management, so they share the incentive to align interests. Activists simply asking companies to buy back shares is nonsense right now.” *Portfolio manager, APAC hedge fund*
- “**I do not want to see people taking advantage of the current situation by taking companies private at a cheap valuation because that is not taking shareholder interests seriously.** That privatization is the biggest reason for an ADR discount. There have been ADRs we invested

in the past that have seen the share price drop dramatically leading to privatization of the company at a price that is half of what we thought it was worth.” *Portfolio manager, UK investment manager (>\$35B EAUM)*

A few investors and analysts state that the current environment does not impact how they view the role of activism.

- **“It is too early to tell how COVID-19 has impacted shareholder activism.** We are still trying to get used to the new situation. Things have not been delayed or scaled back. The key question that comes up is that some companies are asking for more capital to keep going, so you have to make a decision to participate in these rights issues. That is front and center of attention.” *Analyst, UK investment manager (\$90B EAUM)*
- **“Our view on shareholder activism has not changed at all. We would still support campaigns that we believe in. The current market environment would not change our way of dealing with investor behavior.”** *Analyst, South African investment manager (>\$2B EAUM)*
- **“As long-term investors, we have never been ones for activism. We have always engaged with management on a proactive basis. We always participate with letters to the Board and raising concerns in a very collaborative way. It was never our style to be quite hostile and take an activist approach. We have always been quite collaborative and have progressively moved up the chain to have our voices heard.”** *Portfolio manager, UK investment manager (\$50B EAUM)*
- **“At this time, COVID-19 has not impacted my view on shareholder activism. It is not something that I have taken into consideration yet.”** *Analyst, US hedge fund*
- **“COVID-19 has not impacted my view on shareholder activism at all. We are very engaged in situations, so we are constantly looking at different areas. We would do the same actions as before, even taking COVID-19 into consideration.”** *Portfolio manager, US investment manager (>\$90B EAUM)*
- **“The current situation has not impacted my view on shareholder activism. It is generally a waste of energy, but sometimes it can be wonderful. Some individuals do it very well. Most individuals that try to do it are amateurs. COVID-19 does not change that. My recommendation for companies facing activist campaigns is to simply pay attention.** Do not assume that just because you can outvote someone you do not have to listen. You must assess the quality of the activist. If they are not serious, then you can disregard them. If the activist is good, try to compromise. There are activists who over time have really helped companies, engaged with them, and hired the appropriate individuals to improve them. There are other activists who are not like that. When a company issues shares, it is initiating a partnership. Some companies do not understand that. I know some CEOs who do not believe that this is the case. They believe the shareholder is simply a source of money. In reality, you are engaged in something once you take that money. If you do it well, chances are you will have a more valuable and profitable company. You will be more politically protected as well.” *Chief investment officer, US investment manager (>\$150M EAUM)*