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TRIVARIATE RESEARCH

DO ACTIVISTS ADD ANY VALUE?

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BACKGROUND AND RESEARCH SUMMARY

We used S&P Global's database to compile a list of activist investors and looked for stocks where activists invested at least 5% of their assets under management and 1% of the companies' outstanding shares. In total, this amounted to 1,588 cases across 1,141 unique stocks we analyzed over the last 20 years. There were 447 instances where either multiple activists were involved in the same stock at the same time, or the same stock saw activist involvement at different points in time.

Three of the most common reasons activists target public companies are:

- 1) **Stewards of Capital:** Activists can criticize a company's history of M&A, changes in net operating profit vs. changes in capital employed, ill-timed buybacks, and other capital allocation decisions.
- 2) **Operational Weakness:** Structurally higher operating expenses, capital intensity, or unproductive employee pools, not reaching its strategic potential are also issues targeted by activists.
- 3) **Governance / Board:** Compensation and ill-aligned variable compensation, weak oversight, and incentives are not aligned with shareholder returns.

Interestingly though, when we analyze the relative-to-industry attributes of stocks with activists, we don't see a material difference in capital intensity between targeted stocks and non-activist stocks. Operating expense intensity is modestly higher. Forecasted revenue growth is on average in-line. In aggregate, activists often aren't pursuing inferior relative-to-industry-average securities.

Activist targets: A slightly higher percentage of stocks that activists pursue are growth than value. Nearly 2/3rd of stocks that have activists involved are in the bottom half of quality. Consumer Discretionary, Technology, and Healthcare companies attract activists more than any other sectors. Overall, the number of activist situations is down over the last few years. Activists on average have sought higher beta stocks, a sign that volatility is more easily introduced into these companies' P&Ls than non-activist stocks.

INVESTMENT CONCLUSIONS

Performance: We looked at the cumulative relative-to-industry returns of activists taking more than a 1% position in a stock and 5% of their assets among the top 2000 US equities and **found they have not added any cumulative value vs. the average stock in the industries in which the stocks were classified. As an asset class, we don't think the data show that activism as a strategy works.** There are managers/stocks that contradict the data and outperform, but the aggregate system appears to add no excess return.

Sector: It seems like activists have done better as of late in Real Estate stocks, but consistently not fared well in Financials.

Substance: While the highest percentage of stocks with activists are “junk”, this group is by far the worst performing quality bucket and perhaps the only cohort worth avoiding based on systematic evidence. **Activists should avoid junk stocks, but instead they over-index toward them.**

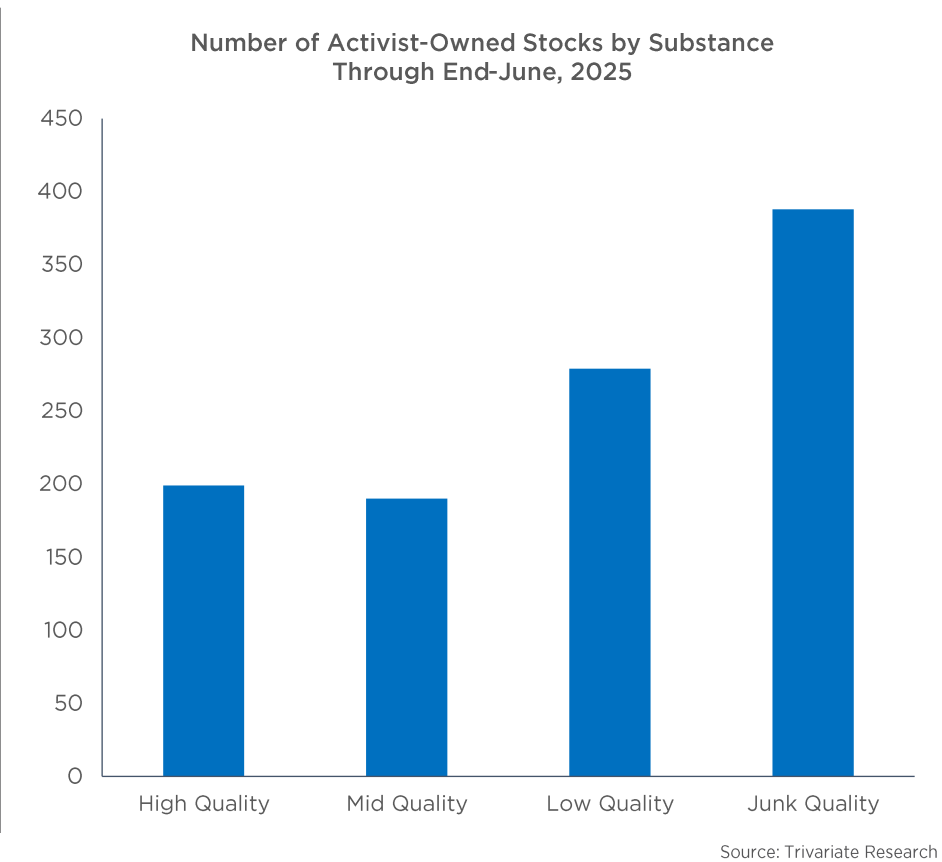
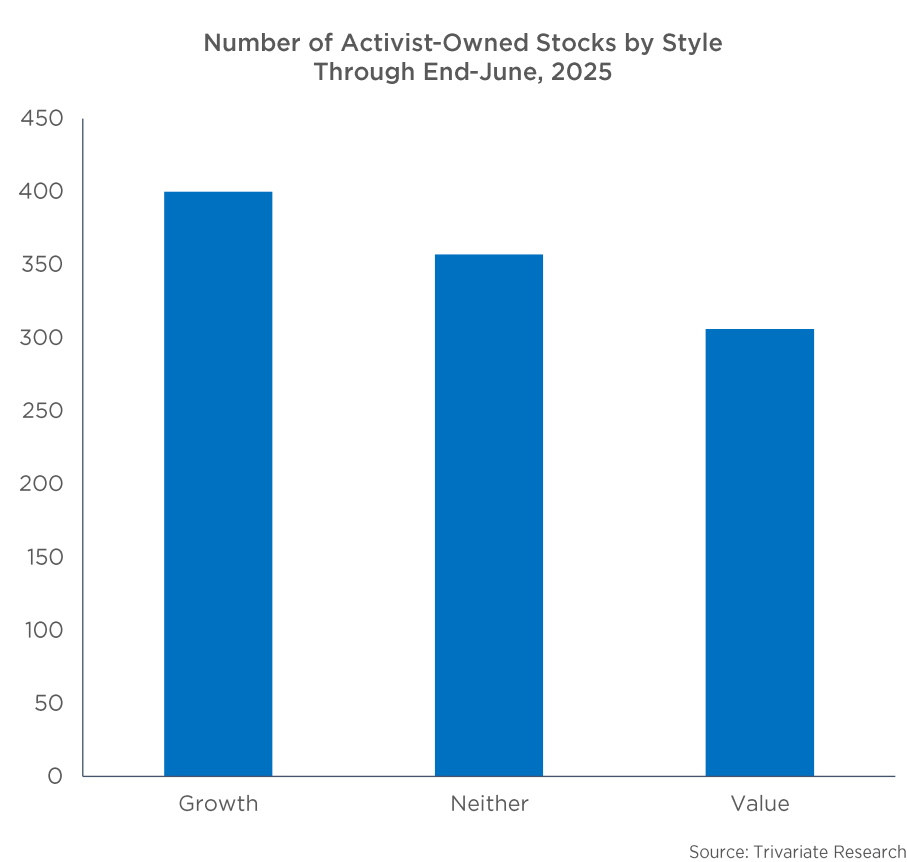
Activist position size: Does it matter if an activist puts “their money where their mouth is” by taking huge positions vs. just medium-sized? Not really, the stocks they own more than 5% of the company on average lag those where they own 3-5% of the company. **So, size doesn't matter.**

Announcement: The performance of stocks with activists is typically only good right out of the gate, for new positions, whereas holding the position, or changing the position size does not add any value. Hence, finding out that your favorite activist took a large stake does not on average improve results. **It seems like the primary benefit of being an activist investor is announcing your active position.**

Company-specific risk (CSR): Generally, activism works better on more macro stocks, as stocks with high company-specific risk (CSR) that have activists have materially lagged those that have low CSR following the announcement of the activist's position. **If an activist announces a stake in a high CSR stocks or junk stock, chasing their announcement is a poor strategy.**

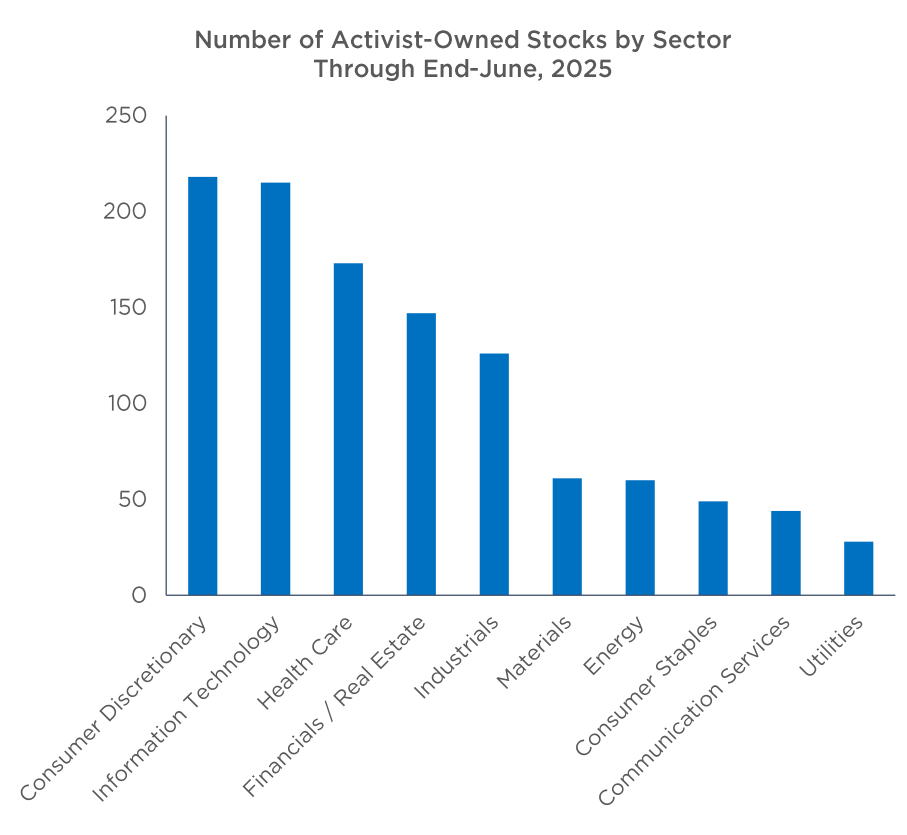
AMONG ACTIVIST STOCKS: 2X AS MANY JUNK AS HIGH QUALITY

A slightly higher percentage of stocks that activists pursue are growth than value (left). Nearly 2/3rd of stocks that have activists are in the bottom half of quality. Stocks with activists are about twice as likely to be junk than high quality (right). Generally, we would not think activists would be as successful or motivated to take stakes in high-quality companies.

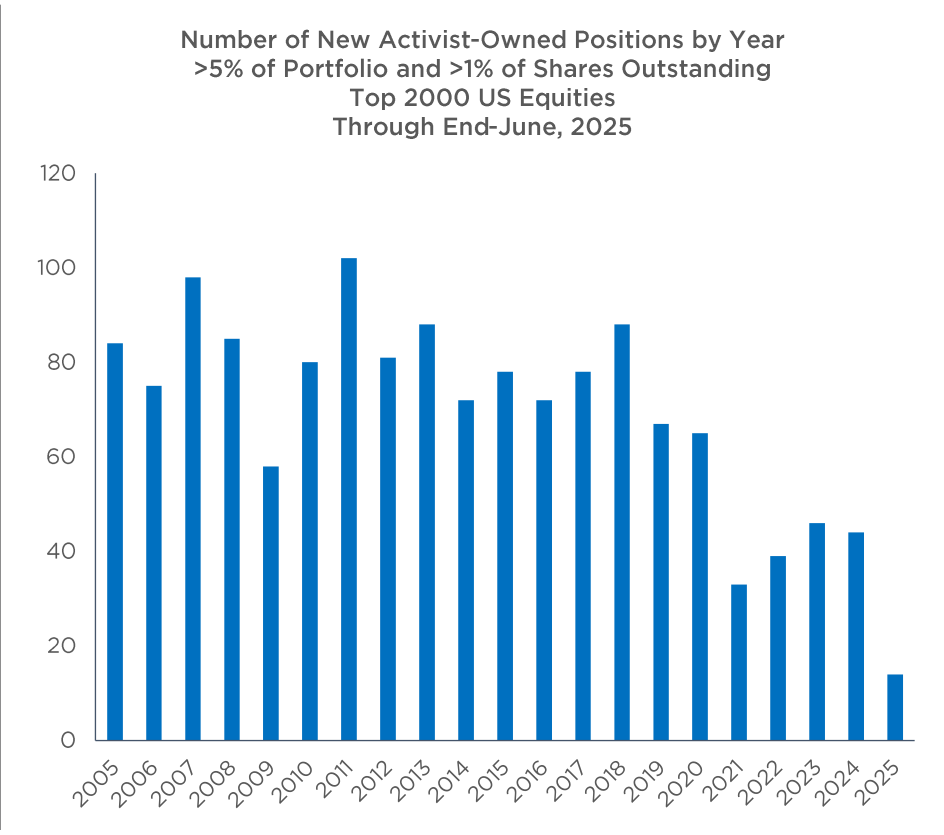


DISCRETIONARY, TECH, AND HEALTHCARE ARE COMMON TARGETS

Consumer Discretionary, Technology, and Healthcare companies attract activists more than any other sector(left). The number of activist situations is down over the last few years (right). This could be a function of the fact the historical track record for efficacy is weak, or because following a strong economic recovery gross margins are near all-time highs for many companies.



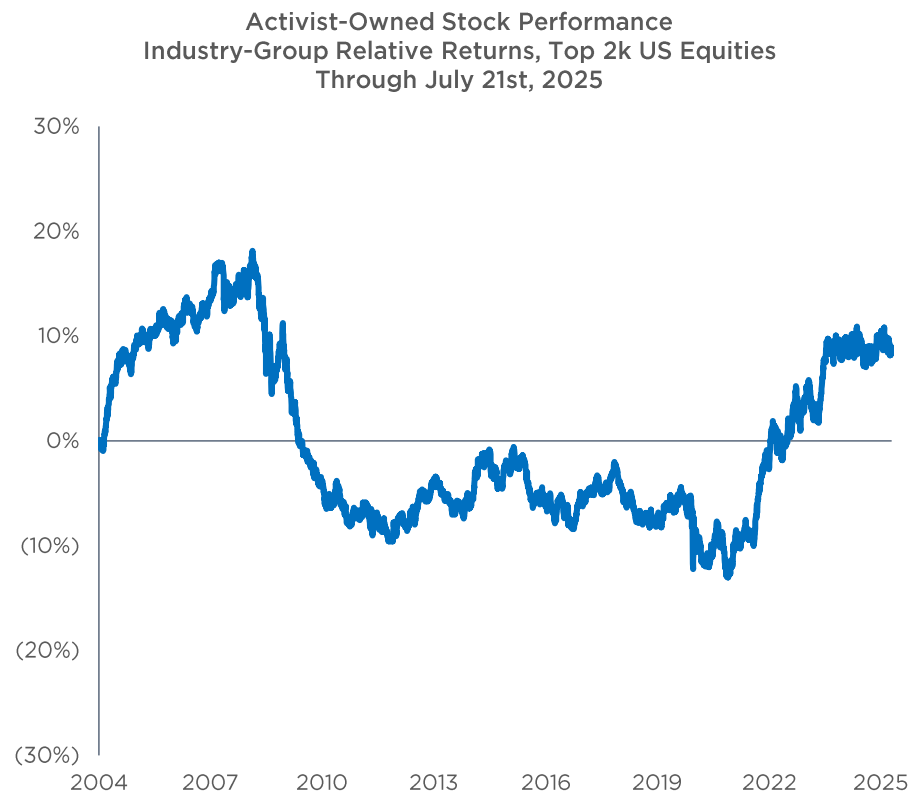
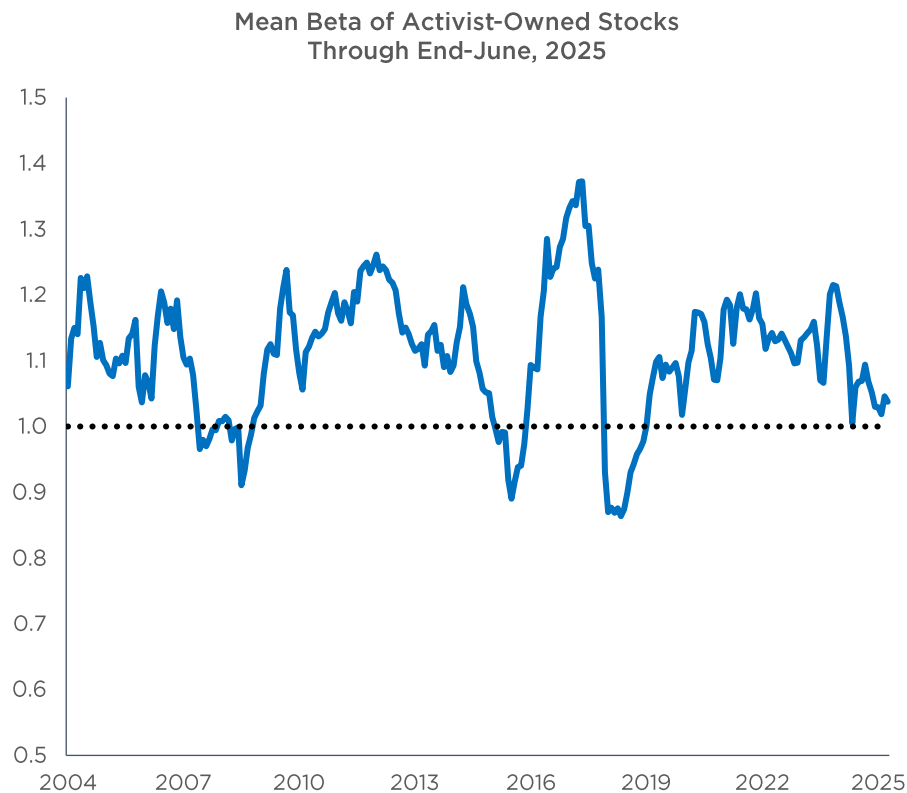
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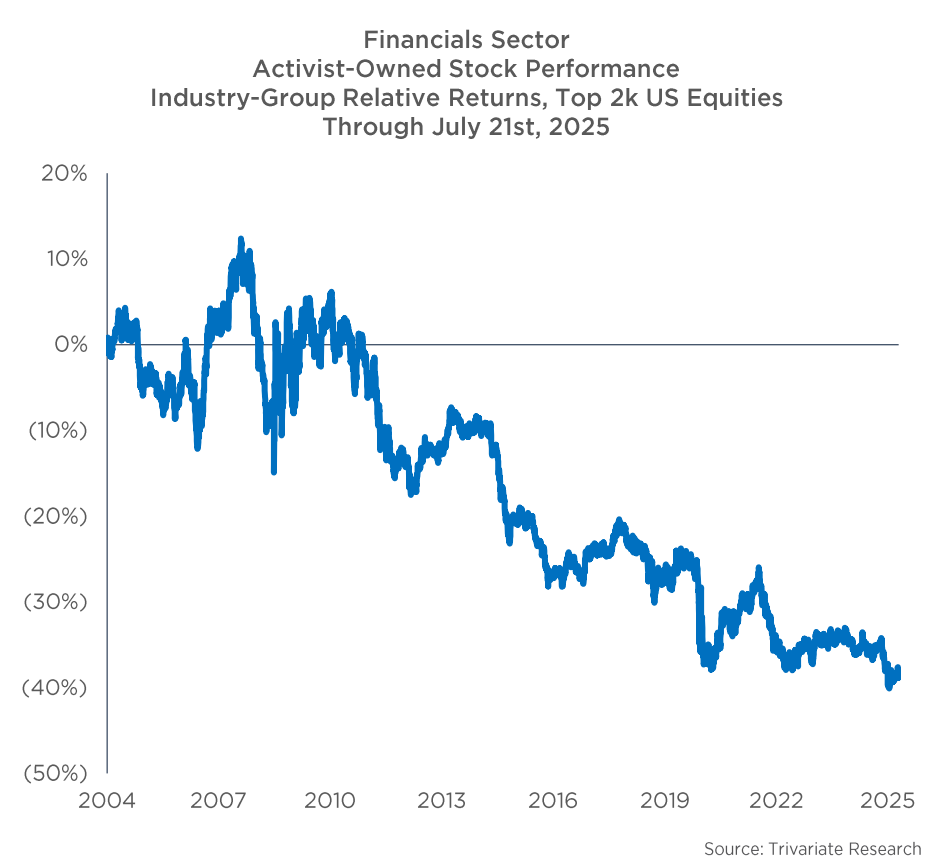
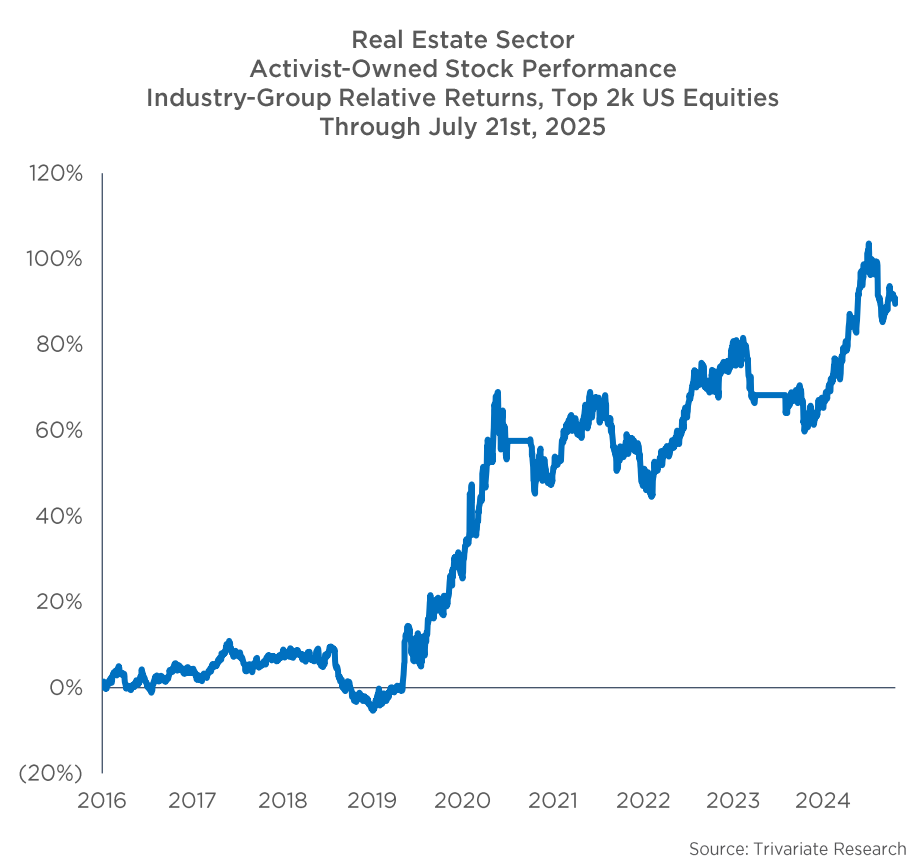
CUMULATIVELY ACTIVISTS HAVE ADDED NO VALUE

In general, activists have sought to invest in higher beta stocks (left), a sign that volatility is more easily introduced into these companies' profit and loss statements than non-activist stocks. We looked at the cumulative relative-to-industry returns of activists taking more than a 1% position in a stock and 5% of their assets among the top 2000 US equities and found they have not added any cumulative value vs. the average stock in the industries in which the stocks were classified (right). As an asset class, we don't think the data show that activism works. There are individual managers and stocks where it does, but the aggregate system appears to add no excess return.



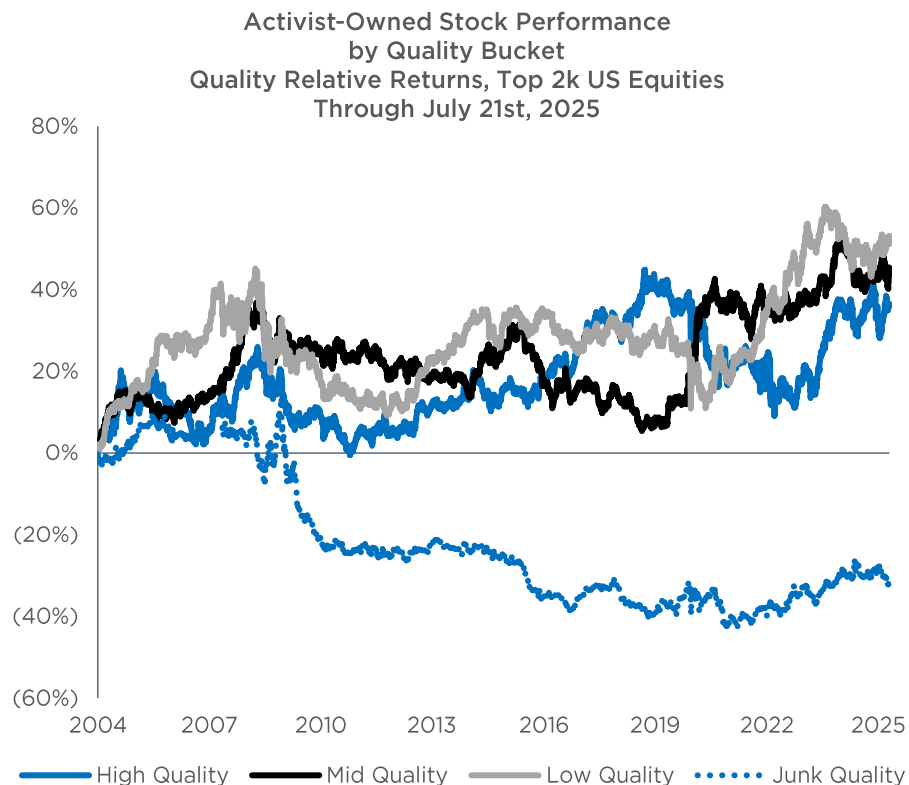
FINANCIALS BETTER FOR ACTIVISTS THAN REAL ESTATE

It seems like activists have done better of late in Real Estate stocks (left), but consistently not done well in Financials (right).

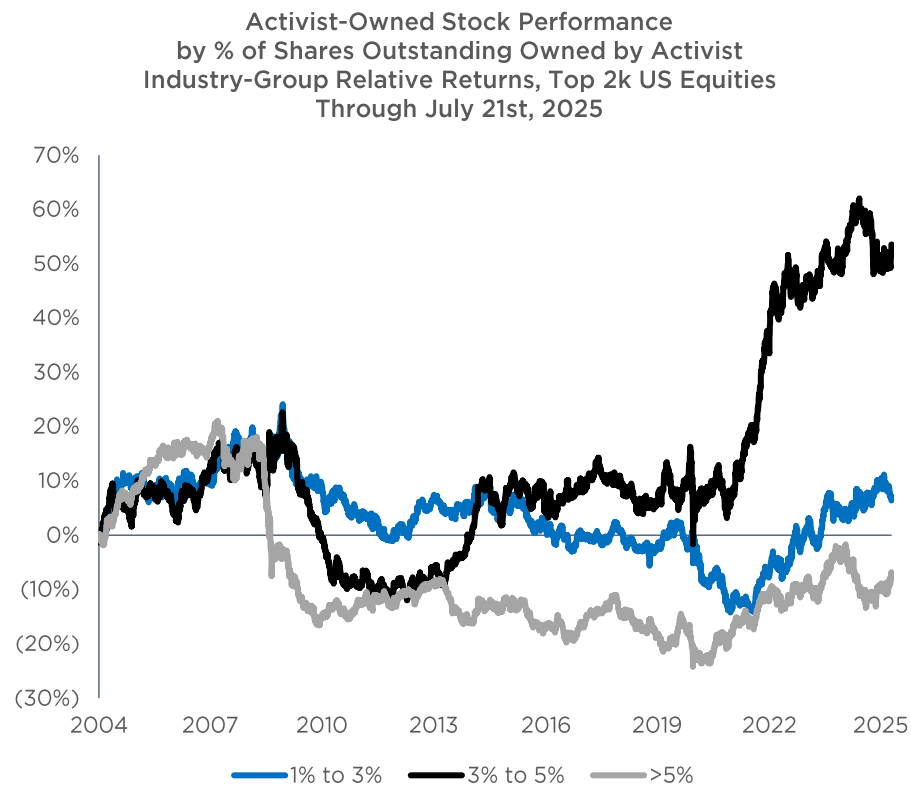


ACTIVISTS SHOULD AVOID JUNK, AND SIZE DOESN'T MATTER

While the highest percentage of stocks with activists are junk, that is by far the worst performing quality bucket (left) and perhaps the only cohort worth avoiding based on systematic evidence. Activists should avoid junk stocks, but instead they over-index toward them. Does it matter if an activist puts “their money where their mouth is” by taking huge positions vs. just medium-sized? Not really, the stocks they own more than 5% of the company on average lag those where they own 3-5% of the company (right). So, size doesn't matter.



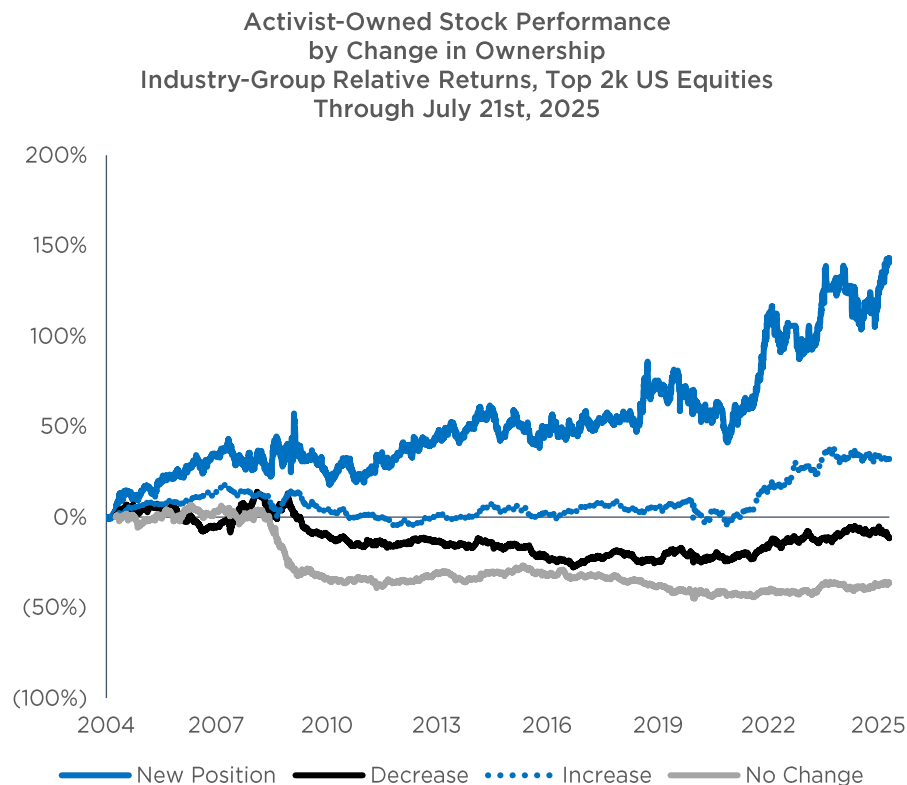
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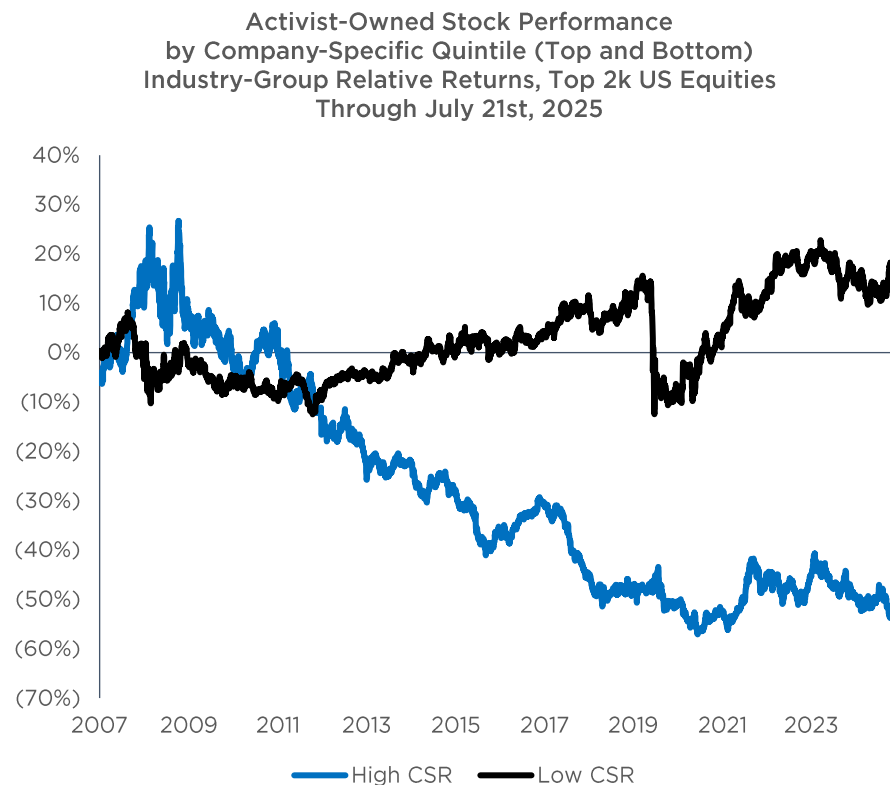
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THE ANNOUNCEMENT WORKS, HIGH CSR IS BAD

The performance of stocks with activists is typically only good right out of the gate, for new positions, whereas holding the position, or changing the position size does not add any value (left). Hence, finding out that your favorite activist took a large stake does not on average improve results. It seems like the only benefit on average of being an activist investor is announcing your active position. Generally, activism works better on more macro stocks, as stocks with high company-specific risk (CSR) that have activists subsequently materially lagged those that have low CSR (right).



Source: Trivariate Research



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