THE ACTIVIST REPORT

13D Monitor

Volume 6 Issue 2 February | 2016

2015/2016: ACTIVIST OPPORTUNITY, NOT OBITUARY

There has been a lot of attention devoted to the returns of shareholder activism in 2015. Rob Kindler basically said that the strategy had peaked. Media commentators are comparing 2015 to 2008 and some are speculating about the end of activism. Certainly, it was one of the worst years in recent history for activist investors and there are many reasons for that. Activists are value investors and value stocks had a horrible year in 2015. The Russell 3000 Value Index was down 6.5% versus the Russell 3000 Growth Index up 3.5% in 2015. Quintessential value investors like Warren Buffet and Seth Klarman were down 12.5% and 6.7%, respectively – for Klarman, only his third losing year in 33 years. However, nobody is predicting that it is the end of value investing.

Activists also have to take some blame. They were not as successful in creating shareholder value through catalysts in 2015 as they have been historically. Many potential mergers were not consummated despite a robust M&A environment. Some of this may also have to do with the evolving nature of shareholder activism from confrontational attacks to shareholder engagement and activists learning how to work in this new environment. It is a lot easier to implement an activist agenda when you win a proxy fight and come in with a shareholder mandate, than when you are quickly invited on to a board after engaging with management.

Activism was also hurt in 2015 from a large selloff in US equities toward the end of the year, and activist positions do not do well during market selloffs. Many stockholders of activist positions are investors who followed the activist in, believe in the activist thesis but have not done a ton of fundamental analysis of their own. When markets start dropping precipitously, the first stocks these investors generally sell are the ones they have the least conviction in – the ones that they followed the activist into. While this greatly affects the stock price, it has absolutely no effect on intrinsic value of the company. That is why these same positions tend to bounce back more after a selloff.

13D Monitor looked at how 13D positions by activist hedge funds did pre-selloff, during the selloff and post selloff in six market selloffs between 2009 and 2016. The average 13D returned 10.05% pre-selloff versus 6.07% for the S&P500. During the selloff, the average 13D fell 16.98% versus an average decline of 14.31% for the S&P500 during that same periods. After the selloff, the average 13D bounced back an average of 43.65% measured until the 13D was exited, versus an average of 24.81% for the S&P500 during the same time periods.

	Pre Sell-Off		Sell-Off		Post Sell-Off	
Year	13D	S&P	13D	S&P	13D	S&P
2009	11.09%	-3.69%	-21.87%	-22.23%	145.48%	64.83%
2010	16.90%	9.16%	-17.57%	-15.99%	25.28%	22.99%
2011	10.12%	6.95%	-22.30%	-18.27%	23.47%	14.41%
2012	15.41%	11.79%	-7.28%	-9.08%	10.96%	11.28%
2014	5.06%	8.82%	-8.71%	-7.40%	13.05%	10.55%
2015/16	1.72%	3.37%	-24.16%	-12.91%	?	?
Average	10.05%	6.07%	-16.98%	-14.31%	43.65%	24.81%

Many commentators have also looked at 2008 and 2009 and have extrapolated that 2016 could be a slower year for new activist engagements. In 2008, there were 118 new activist 13D filings versus 50 in 2009. In large part, this is because activists were not prepared for the redemptions they were getting and did not have capital for new investments. Also, with many of their current positions significantly under water, they were working on creating value at those companies and if they were exiting positions, it was often to finance redemption requests. While we may experience a slowdown in activist engagements in 2016, it is unlikely to be anything close to 2009 for several reasons: 2015 was not nearly as bad as 2008, the level of redemptions activists are receiving is much less than what we saw in 2008 and activists are more prepared for redemptions, have longer lockup periods and some have permanent capital.

While 2009 was a very slow year for new activist engagements, it was one of the best years for returns on activist 13D filings. For example, for premium activist investors who had positions in $1 billion+ market cap companies, the average return on a 13D in 2009 was 48.6%, versus an average of 23.5% for the S&P500 during the same time periods. That was after a 2008 when they averaged -25.4% versus -38.5% for the S&P500. We attribute this to several things. First, after a large downturn in the market, particularly with such a large divergence between market price and intrinsic value of value stocks, activists have many more targets to choose from. Second, in down markets, it is harder for poor management to hide. And finally, with markets down most portfolio managers are under water and it is easier to get the support of other shareholders for activist agendas.

Activism has grown tremendously over the past five and ten years and will continue to grow into the future. It will naturally have some growing pains along the way. But 2015 was not the beginning of the end of activism but more like the end of the beginning.