Activist Investors Go Big

Wall Street Journal
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October 1, 2013

Big companies sitting on piles of cash or shelling it out to their executives better beware: activist investors are targeting you.

This year, 60% of activists’ campaigns have focused on getting companies to boost returns or shake up their board. A record 30% of the campaigns have been aimed at big companies, almost double the average over the like period for the past four years, according to FactSet SharkWatch. The data provider defines large companies as those whose market value exceeds $1 billion.

“If there’s a lot of cash on your balance sheet, the argument is you’re not getting an adequate return on cash, and you need to do buybacks or dividends,” said Alex Khutorsky, managing director at Valence Group, a New York investment bank. Mr. Khutorsky said he is getting lots of calls from companies for advice on defensive strategies.

Forty-one activist campaigns this year have demanded that companies return cash to shareholders via dividends or buybacks, up more than 50% from a year earlier, according to SharkWatch. Skittishness about the economy and the lack of political harmony in Washington have prompted companies to sit on near-record cash troves, totaling more than $1.8 trillion, according to Federal Reserve data.

Investors say that conditions for activism are the ripest in years. Fund managers have amassed their own cash reserves, fueled by rising stock prices, and can borrow at low interest rates if they want to build influential stakes in companies. They also are taking off the kid gloves. Proxy fights are at a five-year peak, with most of them focused on booting out directors.

“People are starting to realize that no one is safe,” Mr. Khutorsky said, adding, “Companies are thinking through their vulnerabilities.”

Many companies have quelled activist-led rebellions by distributing cash through dividends and share repurchases. Of the companies in the S&P 500 index, 83% are offering cash dividends, the most since the late 1990s, according to FactSet. Altogether they doled out $329 billion during the year ended in July, double the amount 10 years earlier. Buybacks, meanwhile, spiked to $122.8 billion between May and July, the highest level for a fiscal quarter in nearly two years.

Companies aren’t thrilled to have an activist knock on their door, because proxy battles can be costly. Earlier this year, OshKosh Corp. said billionaire Carl Icahn’s failed effort to shake up its board and acquire control of the specialty-vehicle maker cost the company more than $16.3 million, or 11 cents a share.

Time, too, is money. Activists “can just suck the living daylights out of management,” said Michael Smiley, chief financial officer of Zebra Technologies Corp. and a director of Twin Disc Inc., a power-transmission equipment maker. In 2007, one of the most-active years for
shareholder revolts against small companies, Twin Disc was targeted by activists who wanted it to put itself up for sale, but the activists failed to win wide support.

Managers can easily become consumed by their discussions with activists, Mr. Smiley said, spending days preparing with lawyers and advisers, while also having to update the board and oversee daily operations.

Of course, shareholders’ suggestions can be valuable. “Sometimes they have good ideas that help address some of the sacred cows companies have,” he added.

Between 1994 and 2007, companies targeted by activist hedge funds experienced, on average, an initial 6% rise in their stock price and improved their performance against peers by about two-thirds, according to a study by Lucian Bebchuk, director of the corporate-governance program at Harvard Law School.

“People would be amazed at how poorly some companies are run,” Mr. Icahn says of public companies generally, adding that “in many ways corporate governance is worse than it was 20 years ago.”

Over the past two years, Apple Inc. has assuaged some activists with its dividend and buyback programs. But in August, Mr. Icahn disclosed a “large position” in the still cash-rich gadget maker. More recently he tweeted that he was to meet with Apple CEO Tim Cook to discuss the “magnitude of its share-repurchase program.”

Last week, CtW Investment Group sent a letter to the chairman of Oracle Corp.’s compensation committee, threatening to vote against Oracle’s pay practices, and possibly against directors who sit on the committee, if Oracle doesn’t make changes that include limiting stock-option-based awards to executives.

Oracle has said changes in its pay practices aren’t warranted.