The information on this transcript and podcast is of a general nature only and does not take into account the objectives, financial situation or needs of any particular person. Before making an investment decision you should consult with your financial adviser & consider how appropriate the advice (if any) is to your objectives, financial situation and needs.

Transcript of my interview with Jeremy Leibler on the Finance Hour

(24 April 2019)

Reuben Zelwer: We now have Jeremy Leibler on the phone and the topic of this week show is shareholder activism. Jeremy's a partner in commercial and corporate law at Arnold Bloch Leibler. Jeremy, welcome to the show.

Jeremy Leibler: Thanks for having me, Reuben.

Reuben Zelwer: Great. Well great to have you on. And , I introduced the topic shareholder activism. , but I think that most people will still be confused what that term actually means. So can you give us a quick overview of what shareholder activism actually is?

Jeremy Leibler: And it's a reasonable question because what's the difference between a shareholder activist and any other investor in managing their money? But there is a difference and most shareholders will, investors will invest in a company and , on the basis that there's a fist the prospects of that company and hope that the value of the investment increases, the activist is a little bit different. They may identify a company that they actually think is undervalued. but they believe they can affect that change themselves. So they will, take a position often a lot of large position and , then seek to affect change, be that , an asset acquisition or disposal, a change of management change in the board or a return of capital. It can manifest itself in any many different ways.

Reuben Zelwer: When you hear the word activism, I don't know you sort of think of social activism or alike but do people, I mean, did they shareholders if it has like a social sort of one of the social good or is it really just about making more money?

Jeremy Leibler: I would say social activism does play out. It plays out more in the US than it is in Australia so far. And it's not so much about the activist having a strong social conscience, but there's a very interesting phenomenon in the US at the moment where, with the growth and popularity of index funds, these index funds effectively controls something like 30%. Many of the large listed companies in the US, they can't buy or sell. Right? They have to hold those shares because I have to reflect the index. That's right. So they can take very long term views about value creation and often they are very interested. The index funds are very interested in things like gender diversity, environmental sustainability. So what the activist funds often do is they will issue a white paper and the first 10 pages of that white paper will be about gender diversity and sustainability. And the next five will be that, oh and by the way we think should break up the company. And they do that because if in effect they can appeal to the index funds who own very substantial proportions of these companies. If they can appeal to those farmers to support them, well they've got the vote and therefore the leverage on the board in the bag.

Reuben Zelwer: So that's interesting so just for our listeners so obviously, fund management there are two types, active fund managers who research companies and try and identify ones that are undervalued and make money through active research. And then there's a huge number as it says, index type funds, which all they try and do is track an index like the ASX 200 or the Dow Jones and they're not trying to add any value. And indexing has taken a significant increase. It's huge in America. And that's growing here as well. But it is really interesting to around, I'm surprised that the index funds are involved cause I would've thought the whole concept and the next one is just to track the index and of that's it. You're saying that they're actually, even though they're not researching individual companies, that they, they want to take a position to grow the overall value of their investments.

Jeremy Leibler: I can't tell if they're not happy with an investment. Even if anything management's crap, I can't fill his shoes. , so how do they affect long term change without looking at studies that show that having a diversity of opinion but gender background generally around the table. , and that's what the data shows, by the way. It shows that having that diversity of opinion actually supports resulted in, in been a shareholder growth and returns. So they will try and affect change over the longer term on these sorts of issues and activists. We'll use that in order to garner more support for their own objectives, which tends to be more focused on value creation.

Reuben Zelwer: Yeah, the biggest shareholders, big fund managers and also the industry super funds, which I want to talk about in a minute, but let's just leave that aside just for now. , so you've talked about in America, but how does that, how does it play out here? Is that index funds doing the same thing or active fund managers doing, doing that as well? What's the situation in Australia?

Jeremy Leibler: The index fund in Australia haven't quite penetrated to the same extent as in America, but it's growing very significantly in popularity, especially after the Royal Commission. , but in terms of the industry funds, , they are increasingly playing a very important role in, in activism battles and , you've seen them get involved in one's like pitch or getting involved in brick works. And there are, there are other examples, similar sorts of examples. So the industry funds activists, I'll will and are looking to the industry funds, for support. And I think the industry is founded on, I have now starting to dip their toe in the water side and we'll explore what role I want to carve out for themselves. And despite, I think historically there was some sort of negative connotation associated with activism. As I said, we sort of green mailing and holding a company's ransom, but I think now it's become far more accepted and established. , it is literally an asset class in the US. Certainly there are many, many multi billion dollar funds that our activism funds and in Australia gives you the same to direct our couple of listed , activism funds and also quite a few private ones as well. Yeah. They're not yet playing at the very beginning of time here other than what we saw with , Elliot's come in relation to BHP generally. It hasn't been at the very beginning of town, but I predicted that will change over time.

Reuben Zelwer: Yes.

Jeremy Leibler: The with funds realize that Australia actually has the far friendlier regulatory environment for activists then the US.

Jeremy Leibler: Europe or Asia.

Reuben Zelwer: So you're saying that the activist aren't necessarily the fund managers themselves, they're separate entity that then trying to entice the fund managers to follow their lead?

Jeremy Leibler: That's right. But that's exactly, and there'll be different models, but I think, yeah, I don't think the industry funds are at a point where they're going to drive it to themselves, but they will now lend their support. And an example of wasn't an industry fund, but, an example was a matter, I was involved in the fund management software company called Praemium where the longtime see, , and about 4% of the company was effectively terminated by the board who had a difference of opinion in terms of strategy of the company. He came, he came to us and we, sort of lead them through the process of calling an EGM spill, a board that he was able to do so because he successfully got the support of paradise investments who are large shareholders in the group and a couple of other large major shareholders as well.

Jeremy Leibler:	But that was a situation where in a paradise, there were a fund manager with a $15 billion of funds under management. This was a company with a, it was a mid cap company. , and , in the scheme of their portfolio wouldn't, nothing material, but they obviously saw an opportunity to, to, to be vocal and ensure that the value in their investment was, was maintained. It would grow, as much as possible. Now, the other factor here that the playing into both, the industry funds and other fund managers generally be more open to supporting activists is that fund managers are under enormous pressure to justify their fees because you will, if you look historically at most fund managers performance, they either perform below or similar to index but they charge very onerous fees. So that's why many people are moving their, their ,their assets, their investments to index funds. Warren Buffet, he famously made a bet with a hedge fund manager that the index would out perform these hedge fund over 10 years and won the bet. Fund managers are now having to in effect justify their fee model in existence by not simply being passive and by saying, Hey, we actually don't just pick stocks but we create value. We effect change within companies to generate superior returns. It was that or not, it's a different story
Reuben Zelwer:	So that's interesting because yeah but at the of the day better if there returns because the traditional way that they would say that they would try and get better returns is by researching the company and finding undervalued investments that that's the way that they would try to add value. But this is an interesting, so the second, second way that they may be able to, but I guess I just, let me just understand. So these activists that are sort of the, that are not the fund managers themselves, what's, what's their sort of business model? I mean, what are they
Jeremy Leibler:	If you term them broadly an activist can be a high net wealth individual or a family central holding in a company and, and wanted to do something about it. I'm not happy with the state of affairs. They're an activist as they're going to publicly actively advocate for change that makes them an activist. And , people like Solomon Lew fall into that category. , when these campaigns in relation to Meyer and Country Road and David Jones, very much an accident. But then you've got others like fandom capital, which is a listed, which is a fund with Janette has investors and they take positions in companies with a view to effect change and might take a view where they think there's an opportunity for capital to be returned and effectively advocate for, for the company to do that and benefit from the arbitrage or , asset acquisitions or disposals.
Reuben Zelwer:	But that would need to be very big, affect the big companies, going after the smaller companies.
Jeremy Leibler:	Yeah, look, yes and historically, yes. But what we've seen the US is maybe the successful activist campaigns have been done with very, very small percentages of the company. Maybe 1% the unlike what differentiates shareholder activism from, hostile M and A is it the activist had absolutely no intentional desire to acquire these companies. What they do is they put forward as a proposition and

investment thesis and then they publicly Ghana, run a campaign to get support from other shareholders to affect that change.

Reuben Zelwer: Individuals can be activists as well so that's when individuals got large stake in the company or not, or not even necessarily

Jeremy Leibler: Thoroughly ever. We've seen these sorts of campaigns that we can as a CEO in the premium example. But yeah, he was a relatively significant shelter but not, not material. , Solomon Lew had a 10% shareholding in Maya and something similar in Darwin Jones when he, when he launched those activists campaigns. So we can varied, it depends on the makeup of the registered as a handful of large institutions who were on board will, you don't need to actually have a large shareholding. I can, you're taking more notice. I buy target board if, if you've got a decent shareholder,

Reuben Zelwer: Yes. An activist or an agitator. He said the seems to get up at the, at the various AGM and , has a massive crack at the boards and CEOs. Is that actually an activist and how does this do these things tend to play out at AGM to AGMS, get to get pretty fiery. When these activists, jump up and challenged the board or the CEOs

Jeremy Leibler: If executed properly, it creates an ability for an activist or a shareholder to draw attention to an issue of confirm if they know how to, ensure that the media was there and it gets coverage and , and , and the like, then, then it can be very effective. I mean, Steven Mayne, yeah, he's a form of an activist. I mean, I think people take a lot less notice of him now than they did originally where he was originally was a bit of a thorn in the side of directors insisting that they own shares and they were independent. To be honest, he sort of lost quite a bit of credibility because only people was going literally buy one share and again, a whole bunch of companies. Yeah. The AGM. And I think that would be the other extreme where people just felt he actually had no skin in the game. He had no real interest in this much of this as a publicity stunt. But don't take a lot of notice.

Reuben Zelwer: If you're listening and you want to come on, you feel like Jeremy has had an unfair crack at you and feel free to feel free to fire back. I sort of noticed as well from time to time is these are, executive remuneration things. There's that, that concept of, often these companies, , the shelves will say, look, we reckon you're paying the executives too much and then they get, it's okay the first time and the second time it's okay. And then the third time there's a strike. I mean, can you, is that a form of activism? Can, what, can you actually explain, explain those rules? Because I get very confused by them personally

Jeremy Leibler: Its called a two strikes rule in the act of the staff and all, which can be very, very powerful not withstanding, but fundamentally it's a blunt instrument. So the way the rule works is that, every listed company has to put forward a nonbinding resolution to adopt the remuneration report, which is the report that talks about how much they pay their senior and senior executives and the board. , and it's a nonbinding resolution. But if more than 25% of shareholders voted against us, they get a strike. So it's a much a low threshold. Most other resolutions or 50% or higher and this one is, it's 25% so it does create leverage for an activist to , put pressure on the board. If there are two strikes two years in a row with their strikes, we'll then there's an automatic spill off the board. And that means that there's another vote to determining for whole board should be at and an election to reelect them. The reason why it's ultimately a blunt, he was tremendous because after two strikes, that vote is 60% so while 25% protests, bud can put pressure. Ultimately the 50% threshold is required to actually unseat the board.

Reuben Zelwer: So you're saying that two votes for 25% allow that motion to be put for the board

Reuben Zelwer: Exactly. At the moment. I mean, what does it take to put a motion to spill the board? Is it more than 25%

Jeremy Leibler: Well to shareholders with more than 5% can requisition a meeting. So that right, that power is there. In any event. I think the reason why, and that's why I described it as ultimately is a blunt instrument, it's still very powerful because directors, particularly with the more serious companies don't want the reputational damage of having a strike. And certainly not of having a second strike because the way in which our director call it non executive director because my book is, it's a relatively small group of nonexecutive directors who are frankly all know each other and this once it's on the other one, that board on that one then invite her or him to sit on his board. And it's all quite incestuous. And what that means is it actually gives leverage to activists who can use the prospect of reputational damage to a, a target to engage with the activist demands. , no director wants their reputation to be tarnished, which would then prejudice the next potential bolt appointment.

Reuben Zelwer: So that's actually an interesting segue way because you are talking about the conversations of boards and you're talking about before about , diversity and seeing how participation, so you said you described as sort of no executive director boards. Is that, is that really like tap on the shoulder mates coming on, et Cetera? Is that, is there no real push for diversity or has not been successful? , getting different people, range of people and skills on the board.

Jeremy Leibler: There's definitely been progress and there's a lot of talk about it and this is not, gender diversity is one part of it. , which, there's still a long way to go, but it's not just gender diversity, it's just stuff that's the background generally. And I think, the problem historically is the board were almost exclusively made up of, , 55 60 year old plus white males who all went to the same or similar high school and university. , and, look the same and things the same. I talk to that

Jeremy Leibler: But also that just don't bring a diversity of opinion to the table. And , what's very clean, Abbott Datta is that where you have people from different backgrounds, different perspectives that actually has something to bring to the table. , so it's not that bad anymore. And , there's a lot of talk about targets and boards. , there's a lot of pressure on boards to have some sort of gender diversity. , but , there's a long way to go and I don't think anyone has actually cracked the code and it's not just about having quotas or targets and getting women on, it's actually about creating those opportunities earlier on. , also to ensure that we don't set up these people for failure when they join these boards.

Reuben Zelwer: Yeah. Isn't that a risk sometimes let's say if you specifically target diversity be it gender or on any other basis and if you have people to take the positions or they're not really prepared for, I mean, that was, whether or not this was fair or not, that was something that was leveled a little bit of Catherine Livingstone of amp, that perhaps she was,

Jeremy Leibler: She wasn't ready for that role.

Reuben Zelwer: Well, I don't know if that was fair or not that there was some discussion about that. Having said that, you could say, Ken Henry also got sect. , but do you think that's a risk?

Jeremy Leibler: Okay. That's a risk going. Ultimately their primary obligation is to be able to act in the best interest of shareholders. But at the same time, the data clearly shows that it's in shareholders' interest to have diversity on the board. And then that's not to say it all has to happen in one go and they have to make sure they've got the right people. That's the primary obligation. And that's why this whole issue is not just about boards. It's, it's about creating culture within our, sort of economy and the business world that facilitates these opportunities and the training that leads to it. But I think it's also very convenient for boards to say, am I, Oh look, we just don't have the talent pool, available. So we're going to have to keep on doing the assignment saying someone needs to break that cycle. , and it is achievable. It just needs to be done in a concerted and, , frankly common sense. Right.

Reuben Zelwer: Well, I mean this is also an issue if you sort of bring different backgrounds that they can be enormously disruptive as well. Have you, have you experienced that yourself? At all in, in both, in the professional world and in communal work.

Jeremy Leibler: Look, you need to ensure cultural fit in any organization. But cultural fit doesn't mean that everyone has to be the same. , I mean, I can tell you, for example, professionally, we find that people that have grown up in the country are a very good fit to work, to work at ABL. They're down to earth, they're focus. , there's something about an upbringing in that environment that makes them suitable now that not everyone works in my office, it was grew, grew up in the country, but that's, there is still a, so there was a cultural fit with people that aren't helpful without, with tables. I'd crop in the country as well. It's not about having everyone the same, it's just about making sure that there's a sense of cohesiveness and the overall culture of the organization. And I think, that's not the same as having, everyone has the same gender or same background

Reuben Zelwer: But it is an interesting thing because i know for board members they are sort of but it's not as though it's like this sort of totally open, marketplace where literally, they go and advertise and anyone can stand to the board. It's someone who's been tapped on the shoulder and then it's almost just, I don't know, , rubber stamped isn't it, by the shareholders?

Jeremy Leibler: Well, most of the time until things go wrong that she hits the fat and then does the revolt by shareholders. Yeah. As a general observation, it's not like there's a very open election campaigns as a sense of trust by shareholders. The boards will do the right thing and seek out, , the right people to lead the company.

Reuben Zelwer: And what point does shareholders like say, no, we want to have a representative on the board. What sort of, what's a typical, typical sort of shareholding percentage they need to have or what's kind of a threshold where, where that will usually happen?

Jeremy Leibler: So there's no requirement, but I mean often you a shareholder with more than 10%, we'll start to have a conversation with the board about some full board representation if it's not themselves even having an an independent who they are, they're looking at for everyone's interest there if this specific nominate. , but usually 10% would be the threshold to start that conversation.

Reuben Zelwer: It's in the public domain, but someone likes, he's main company is something that's in competition I suppose with, with , isn't there an issue there that, someone, get, gets a representative on the board. And is there an issue of confidentiality or the fact that they may use that information, to, to better their own personal thing? Or is that, would that just be a massive breach to the director's duties and no one would ever risk that?

Jeremy Leibler: Well, look, in any situation that there are potential conflicts of interest and there's, hundreds of years of use of corporations law to help direct and navigate so director can navigate their way through those potential conflicts. It's not uncommon though. I mean, you had situations where, Singapore Airlines had a share of virgin, they compete on many routes. There are mechanisms in place so that when there's an issue that comes to the board that relates to potential conflict, that director wouldn't participate. , and , in the case of Maya, early on that would've been, that would've been, the same scenario and the rare, rare circumstances there was a conflict. Whoever the nominee is, would have recused themselves from that conversation. What boards should focus on frankly is who are the best people with the expertise and industry experience to actually add real value to the board because the rest of that stuff can be managed.

Reuben Zelwer: Yeah. When a company wants to take over another company, I don't know whether it's friendly or unfriendly or try and get what, I also try and get positions on the board

Jeremy Leibler: Not necessarily because sometimes it can actually make it harder for him to get control of the company if they're sitting on the board of the target because , they've got certain information that positions if they're making a full beard and they're not currently a shell shelter, no, they wouldn't normally think a board seat. But if that made a beat and , managed to, to buy a stake, a big proportion of the company but not the whole thing, then they, they would often want to see it on the board afterwards in order to keep an eye on their investment.

Reuben Zelwer: Yes. How in any way it's been a negative or what the, what the difficulties, with this rising with this rising concept is?

Jeremy Leibler: Well this is always about short term versus long term and , sometimes criticize particularly in the US for taking very short term. Whereas, and , he's an interest of the bigger picture, longer term view of the company. , I think that argument is becoming improving to be weaker and weaker as we see these activists funds have, very significant funds under management and often advocate for change that will take some time to be effective and be reflected in the value of the company.

Jeremy Leibler: In the earlier days it was about, short term arbitrage opportunities, but that's not just about, activists either, hedge funds off and we'll come onto the register of a company, if there's some sort of transaction or plumbing. I recently was asked to give advice to a target board of a very large company that was subject of a multibillion billion dollar takeover bid. And their dilemma was, well, since the bid was announced and now they're 30 or 40% of the register had changed, there were hedge funds on the register and those hedge funds wanted them to accept the offer because from the price that they bought in and they made a very nice return for that period of time. But the boards about whose in, whose interest do we have to do, we actively interested the hedge funds who just bought into this company. , and, and just want to make a short term profit or of the longer term shareholder who, we think in five years' time this company would be worth multiples of what they're offering now. But obviously there's uncertainty. There's risk in achieving it.

Reuben Zelwer: So were you advising the directors on what their responsibilities were?

Jeremy Leibler: The law very unhelpfully says that you should act, look at what the hypothetical shareholder would want. And of course that's entirely unhelpful to direct and they make that positioning to make that decision. I think ultimately the director needs to get advice, independent advice in relation to the value of the company, the risks associated with, the execution risks with the strategy that that I think would result in greater value and apply some sort of discount to that to, to, to make a decision in relation to whether or not the offer on the table is adequate.

Reuben Zelwer: All right. Jeremy will look like coming towards the end of the show, but will just ask you summer, just one last question. I'm going to ask you activism. Is it positive or negative?

Jeremy Leibler: Oh look, I brought, I think it is what it is, is there, and I think, and I think it's, I think it's positive. , I think that you don't eat will it contributes to creating a more efficient market in Australia. , and I think many, many target boards in this country need a bit of shaking up to keep them on their toes and making sure they've got their on the game and skin in the game, in the interest of all shareholders