

Activist Investors And Credit Quality

With the 2013 northern hemisphere annual meeting season largely drawn to a close, we take a closer look at investors who engage directly with a company's management and board. In recent years, these "activist shareholders" have proven their ability to target larger companies including many with investment grade ratings. What impact do these activist initiatives have on our assessments of a rated issuer's management and governance?

Investment-grade activists do not have to--and with the larger investment-grade companies, likely could not--amass a significant stake in a company to be influential. On April 22, 2013, ValueAct Capital (which we consider an activist investor) announced its \$2 billion investment in **Microsoft Corp.** (AAA/Stable/--) but it typically holds stakes in a small number of companies and seeks board seats or asks for strategic or operational changes. Although this was a large investment by any standards, it is less than 1% of Microsoft's market capitalization, and the size of the investment suggests the activists' engagement with company management and board is likely under way. On June 6, 2013, the Federal Trade Commission announced it granted anti-trust clearance for ValueAct to pursue an as-yet unidentified transaction with Microsoft, so it is the activists' ideas--not the size of their holdings--that present the challenge for managements and boards, and why the latter's responses provide such good insight into their leadership capabilities and qualities. Even the decision not to engage with these investors provides an indication of management and governance characteristics that is illuminating for analytical purposes. We explore other activist investor actions and their analytical impact in our article referenced below.

Potential analytical impact and considerations:

- Has the activist set out a convincing critique or path to change which could, if adopted, positively affect our assessment of the issuer's business risk profile? Conversely, can we state clearly why their initiation would lead to our negative revision of the issuer's business risk profile?
- A company's reaction and responses to an activist are significant indicators of the quality of management and the board, no matter what effect the proposals may have on creditworthiness. Is the response derisive and dismissive? Conversely, does it indicate that management and board have really thought through the points made by the activist and made a convincing response to them, either confirming our current assessment or pointing to the possibility of a different one?
- Does the company's response indicate inattention to the industry or the company's strategic and competitive challenges? Are management and board realistic about corporate prospects in the near to mid-term and is our assessment and management and governance consistent with their response?
- From time to time, companies need to take action to restore competitive position, take strategic action in terms of acquisitions or divestitures or enhance products and services to better serve their customers and clients. Are the activists' proposals in line with these goals, which could enhance credit quality over time, even with costs in the near term?
- Is there any evidence of the use of equity swaps, other derivative arrangements, or securities lending arrangements by the activist that indicate its interests may diverge from those of the company and its other shareholders? Although these derivatives and arrangements may be hard to detect, significant short positions in the company's stock are often a telltale.

For the full article, please see the link below.

[Assessing Management And Governance Quality In U.S. Corporates When Activist Investors Engage](#)