

THE DAILY CHECK-IN WITH GOLDMAN SACHS

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Liz Bowyer: Hi Avi.

Avi Mehrotra: Hey Liz.

Liz Bowyer: So, you advise our clients on shareholder activism and take over defense strategies. There's been a lot happening in this space recently. Describe what you're seeing.

Avi Mehrotra: Yeah, the first thing we're seeing is just really the volumes of activism activity are at an all time high. We are basically seeing the activism market having recovered at the same pace as the M & A markets and the overall financing markets. The level of activism activity today is really the highest we've seen it since 2015, which really started the modern day era of large cap activism with the DuPont proxy fight.

And, you know Liz, the other thing I would say is that all of this is happening despite an equity market that's actually been quite volatile. So, it makes this level of activity all that much more remarkable.

Liz Bowyer: And what's driving all this activity?

Avi Mehrotra: You know, one of the biggest factors driving this activity is really the emergence of non-dedicated activists or funds that really have not done activism in the past, but this is their first time or they're an occasional activist. When you think about all of the activity we've seen this year, over two thirds of that activity in the US has come from these non-dedicated or occasional activists. The most notable of which was, really, Engine No. 1 and their campaign, their very recent campaign against Exxon Mobile, which was their very first proxy fight.

Liz Bowyer: And why now? Why such an influx of activity in the shareholder activism space?

Avi Mehrotra: You know, one of the things that's happening now that I think is reasonably unique is that the M & A market right now is at record highs. That makes it very easy for companies to

sell themselves entirely or to divest a business line. The activists are quite aware that this is the case. And in almost every large cap campaign that we're seeing, they are asking companies to really evaluate their portfolio of businesses with a particular eye on divesting and simplifying their corporate structure.

I think that this M & A market strength is likely to continue as we go forward. And companies are going to be asked to reevaluate what is core and noncore to their business lines against this investor backdrop of really trying to streamline and simplify companies.

We're in, you know, what we're calling a super bloom of corporate separations right now. And we expect this super bloom to continue for some time.

Liz Bowyer: And what about ESG? You mentioned the Exxon Mobile/Engine No. 1 situation, which involved an activist focus on climate issues. What are you seeing with activism and ESG generally?

Avi Mehrotra: Yeah. You know, ESG is actually one of the most important things happening in the landscape of shareholder activism today. You've got very large pockets of capital, what I'll call existing pockets of capital, which are the index funds and the pension funds. And they're very focused on all of these ESG issues. And not only are they focused, but they're actually quite vocal, and very often publicly vocal, about where they stand on these issues.

So, for example, you have BlackRock recently talk about the fact that climate risk is really investment risk. And these pools of capital, these index funds and these pension funds, really own about 25 to 30 percent of many of these large cap companies that happen to be our clients. And on top of that we've got additional capital coming from a whole new generation of investors that care deeply about social and sustainability issues. This generation, whether you call them millennials or Gen Y, have really reshaped the consumer landscape already based on their spending patterns. And now they're starting to reshape the investing landscape based on how they allocate their savings.

This group cares deeply about which asset managers they want to give their funds and savings to. Those asset managers need to have social and sustainability priorities at the forefront of

their agenda.

And so, when you take these two factors, the existing capital that's coming from index funds and pension funds, and this new, growing pocket of capital that's coming from the millennial investors, you get to a very powerful phenomenon around ESG that we think is here to stay.

Liz Bowyer: And how are activists looking to take advantage of this growing pocket of ESG capital?

Avi Mehrotra: Yeah, the activists actually have always used a portion of ESG, the governance portion, as a core component of their activism campaigns. I think going forward, what the activists are going to try and do is to make ESG even more central to the campaign itself, and possibly even build campaigns entirely around ESG. And in that case, the environmental and sustainability portion of the ESG is going to become more critical.

In that sense, we're at a really pivotal moment around ESG activism. And our sense is that ESG criticisms for companies coming from activists are not only going to become more common, they're going to become more central to the argument. And they're going to become more aggressive. And from that standpoint, the activists are really trying to gain the support of this large group of investors that we talked about, both the existing investors, the pension and index funds, as well as this new generation of capital that is continuing to grow.

Liz Bowyer: And how do activists go about selecting the companies that they want to target around ESG?

Avi Mehrotra: Yeah, that's a great question. I think it's important to remember that activists don't invest in a vacuum. When they're selecting a target, especially an ESG target, they're looking to compare that company to its peer group. And really try to identify the companies that they think are the most vulnerable.

So, in that sense, the ESG profile and your ESG standing is not necessarily evaluated in absolute context, but it's very much evaluated in the context of your peers. And so, I think as a company you want to remain in the upper quartile or the upper decile of, you know, performance on the ESG spectrum so that you're less likely to get attacked or criticized by an activist.

Liz Bowyer: And beyond performing in the top decile, what other kinds of advice do you give to clients who are thinking about shareholder activism?

Avi Mehrotra: Yeah, absolutely, that's a great question. And you know, I think the conversation has really gotten now more advanced beyond just having the right disclosures and having the right targets. Those are now just really a starting point. And you've got to really incorporate ESG into your corporate strategy. You've got to reflect that corporate strategy in how you're allocating capital. For instance, how you're spending money around capital expenditures. You need to further show that your board has been involved in reaching those decisions and in thinking that through. And then I think, lastly, you also need to try to align your compensation practices, both in rewarding the management and in the board to make sure that they are consistent with the strategy and the capital allocation that you've laid out around ESG.

Liz Bowyer: So, Avi, a traditional concern in the space has been whether good corporate citizenship translates into financial returns. That conversation has really evolved in recent years. How have you seen it play out in the activist space?

Avi Mehrotra: Yeah, I think it's changing from the sense that companies now realize that doing good is good business. When you think about both your current employees and prospective employees, they care about these issues. And I think it helps in recruiting. It helps in developing and retaining talent. And also, this is a topic that, in particular, resonates with the younger generation of employees. Those employees are not only selecting products and services based on what companies stand for, but they're also increasingly selecting the companies that they want to work for, or their employers based on what they stand for. So, therefore, having socially and sustainability minded companies is really important to them.

Liz Bowyer: And how about cost of capital? I know that's a theme that you emphasize with clients.

Avi Mehrotra: Yeah, that's a really good point. What we've seen over the last couple years is that when companies are out raising financing, if they're doing it in the form of a green bond or a financing that's got some sustainability component to it, they can actually raise money on more attractive terms. And I think over time, if you're able to reduce your cost of capital

by being more ESG friendly and by using these sorts of financings, then that should provide a tailwind, potentially over time to your overall valuation as well.

Liz Bowyer: So, Avi, given all that we're seeing in the activist space, how should companies be thinking about the months and quarters ahead?

Avi Mehrotra: Yeah. I think what it means is that while dedicated activist funds are going to remain very critical and very active, the proliferation of these first time or occasional activists is going to require that companies be more nimble than ever before. It's going to require that there is an extra premium paid on preparation in terms of anticipating where these attacks or criticisms could come from. That, coupled with the ability to adjust to really changing market conditions. And so, for example, what that might mean for a large cap company with multiple business lines is that they really need to keep a constant eye on their sum of the parts valuation versus their current market valuation. And any changes between the two, you know, we need to decide are those temporary and, therefore, possibly cyclical? Or are they more secular? And if it's secular, then the company may need to really reexamine the strategic path that it's on and really rethink through the portfolio of businesses that it's holding onto versus the portfolio of businesses that it may want to divest.

Liz Bowyer: And how about retail investors? They've certainly had a big impact on markets this year. What does that mean in the activist space?

Avi Mehrotra: I think the retail portion of the shareholder register is becoming increasingly important from a shareholder activism standpoint. It used to be the case that, you know, retail was a very reliable supporter of management teams, and it was very much viewed as an asset in the context of a proxy contest. I think now with some of the things that we've seen around GameStop and AMC and how retail investors can really have stocks gyrate quite wildly, if that kind of momentum can be co-opted by an activist, I think that can provide, potentially, a risk area for a company. And so, I think the retail portion of the shareholder register is as important as it's ever been, and probably even more so going forward.

Liz Bowyer: And finally, Avi, anything in terms of the market environment or deal activity that clients should be thinking about?

Avi Mehrotra: Yeah. I think that, you know, as I mentioned earlier, we expect this M & A market to actually be quite strong. And with larger and larger take private transactions happening, such as Medline, I think companies should also reevaluate whether the public markets are really the best place for them, or whether something in that direction can make sense. And it may make sense for the whole company. Or maybe it makes sense for just a portion of the company. But I think this constant view of the portfolio and of the strategy is going to be something that companies need to keep a very mindful eye on.

Liz Bowyer: Thanks, Avi.

Avi Mehrotra: Thank you, Liz.

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