IFB325: Activist Investors: Reshaping Companies like Crown Castle

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Dave [00:00:33]:

Welcome to Investing for Beginners podcast. Today we have episode 325. Today we are going to talk about how activist investors can impact your investments. So this is not a topic we have talked about before, and it is something that's been in the news a little bit lately, and it has affected a company or two that Andrew and I have owned or own. And so we thought maybe this would be an educational conversation for everybody. So with that, I'm going to turn it over to Sir Andrew, and we'll go ahead and start our conversation.

Andrew [00:01:05]:

Thank you, Mr. Dave. So, ironically, the same investment firm is the activists in both of our companies.

Dave [00:01:14]:

Right.

Andrew [00:01:14]:

So for me it's Crowncastle, and for you it's PayPal.

Dave [00:01:18]:

Yes.

Andrew [00:01:19]:

What an activist investor will do, basically, is buy up a bunch of the company and then try to make changes in the company with the hope that they will buy. Kind of like, what's that show I was on CNBC?

Dave [00:01:36]:

Was it succession or Wall street or something like that?

Andrew [00:01:39]:

No, I should have thought about it beforehand, almost like you're coming in and you're doing like a makeover for their business. So they're taking a personal ownership stake. They're trying to affect change to make the business run better, and then they'll either continue to hang on to the stock or they'll sell it after their business transformation is done. So that's kind of in a nutshell. We can take off the headphones and finish our conversation about activists today. Right. But it is a big part of the market, and particularly if you're stock picking in some of the smaller names, that's where you'll tend to see this. And it was a lot more prevalent during the crazy lbo days.

Andrew [00:02:25]:

What that stands for is leverage buyout. And that was when, because of really cheap junk bonds back in the 80s, there were a lot of titans of industry who would come in and they would use a ton of debt to basically buy up a bunch of a company. And it became a huge thing for a while. We haven't seen as much now, but it does still affect your investments. And you could argue Warren Buffett kind of built his career off being an activist in one way or the other. So it is something, I think, to keep in mind when you are picking stocks, hanging on to stocks. And I would also say I would not get nervous necessarily if I saw an activist move in on my company that I own, because it does happen. And so putting it in context hopefully helps you to alleviate some of the pressure that you might feel when you see headlines that say, oh, my gosh, this activist is doing this or that.

Andrew [00:03:22]:

Right? What's kind of been your exposure to activists in your investments?

Dave [00:03:29]:

Well, like you said, elliot has been an activist investor involved in PayPal, which is a company that I've owned for a few years. And they, I think, at least in this particular circumstance, it feels like they were coming in and doing the things that really kind of needed to be done. They were forcing changes that I feel like most investors really felt were necessary, and management was resistant to maybe doing some of these things and maybe had their focus in the wrong places and caused. They caused a lot of management. Making poor choices kind of helped cause a lot of anxiety and also a lot of capital loss for investors because they bet on the wrong things and those things didn't pan out. And then the market saw that and the price dropped a lot. And so a company like Elliot can not swoop in, but they can swoop in, and they can enact change. And sometimes it's awesome, and I think sometimes it's not awesome.

Dave [00:04:45]:

It just kind of depends on what they're really trying to come in and do and what their objectives are. Activist investing is not something I'm intimately familiar with, but I've read some stories from the past, and some of them can be quite confrontational and can be quite antagonistic because they're really trying to come in and force management to do things they don't want to do. And in some cases, not to necessarily break up the company, but kind of break up the company because they feel like there might be parts of the business that are far more profitable and would be better for investors to own that as a separate entity than have know all combined into one particular company. And there are a couple of activist investors that I can think of kind of off the top of my head, Bill Ackman being one and George Soros being another. And they've all had various levels of success doing that with different companies. Sometimes they aren't successful either getting a seat on the board, or they're not successful in being able to force change in the company, or sometimes they just take the company down, too. So there could be that, too.

Andrew [00:05:59]:

Yeah. So maybe, I don't know if it's helpful to talk about kind of the blocking and tackling of activism and how they're able to do that. Companies have different ways that they are run, and you usually have a CEO and an executive team, and you have a board of directors. And so what you tend to have is shareholders will be the ones who decide who the directors are, and then the directors are the ones who rein in the executives and the CEO and stuff like that. So those dynamics are why you see some of these things. And so an activist like Elliot, they don't need to own the entire company to make these kind of choices if they have enough of an ownership stake. And so for Elliot, for example, as of December 7, they had about $2 billion worth of Crown Castle stock. And I'm looking at the market cap now, and it's a market cap of over 51, just a hair over 51 billion.

Andrew [00:07:06]:

So that's about, what, 4% of the company? But what that basically says, in a typical structure, they're going to own about 4% of the voting rights. And if an activist can get some press and talk about the things that they think should change, and if they have a reputation for shaking things up like Elliot does, then what they're hoping to achieve is to have the other voting shareholders on their side and listening to them. And that's a way that an investor doesn't need to have a ton of shares, but can still make a difference. They don't have to be the majority owner to affect the change that they might want to see. That's something that they can do if they have a good reputation and their ideas make sense. Don't have time to search the whole stock market. Tired of waiting through endless information. Instead, get my trusted stock picks@valuespotlight.com.

Dave [00:08:13]:

Yep, exactly. So how does, how does a company like Elliot get on the board of.

Andrew [00:08:22]:

So getting the corporate law and mean that can be really complex. Every corporation has a different set of bylaws. And so depending on what corporation you're talking about, there could be ways to do it. And some corporations, to be frank, there's not much shareholders can do. And so that's kind of why getting down to the nitty gritty and digging through the financials and the government documents, some investors don't like doing it, but it can keep you away from situations like that. But in general, you will see certain shareholders might elect a person to be nominated to be a director, and then you have shareholders vote on that nomination, or management or the board will nominate their own people, and then shareholders will vote yes. Or no, this person can join the board in a typical structure. That's what you'll see.

Andrew [00:09:23]:

Yeah.

Dave [00:09:25]:

The board structure is not, I don't think, a conversation that probably happens a lot, and it can really have a big impact on the business and.

Andrew [00:09:38]:

What.

Dave [00:09:39]:

Kind of impact or input the shareholders can have on the particular business. And I know without kind of really getting into the nitty gritty of it, I know that certain boards are set up such that they can be basically just, yes, people for the CEO. And I know that's one of the criticisms that Elon Musk gets for Tesla, because the board really doesn't know he's a unique individual and they don't really rein him in much with the company. And so I know some of the criticism about the company and the way it's run and kind of the reaction they get from different things is that the board doesn't really hold him accountable for certain things. And so if shareholders don't necessarily agree with what he's doing, they don't feel like they have much say or input in that. So that's something that when you're thinking about the board of the company, it can be helpful to kind of see who's on the board. Is it related to the business? Does it have some sort of connection to what the business does? And sometimes you'll see some very interesting board constructions. You'll see managers or ceos of other companies that have nothing to do with the business they're on.

Dave [00:11:00]:

But they may be incredibly smart people and can contribute lots of great ideas or even accountability to the CEO because of their reputation and things of that nature. I know that Warren and Charlie have both been on lots of boards throughout their career, and I suspect a lot of times it was for that particular reason that they could help hold management accountable, because you're going to listen to Warren Buffett when he speaks. You're going to listen to Charlie Munger when they speak because they have a lot of experience and a lot of.

Andrew [00:11:35]:

Yeah. And to that point, you can argue that the diversity is very helpful. If you have a bunch of people in the same industry, they might miss the forest for the trees because they're all thinking in the same way. An outside observer might say, hey, you know, you guys in that industry, you think that's good, but that's actually not good, so get your head out of there.

Dave [00:11:58]:

Right?

Andrew [00:11:59]:

It is. Yeah. I mean, we could totally go down that rabbit hole, but maybe we'll spare people for now.

Dave [00:12:06]:

Right.

Andrew [00:12:06]:

So what are some of the benefits to activists. Would you want to see an activist maybe put better this way? Because I've had an investment where I had an activist come in, and I saw what was going on, and I was like, okay, I'm out. I voted with my feet, and I was gone. And then another activist more recently, it's been good for the stock price. So as an investor, how is a beginner investor or somebody who's been doing this for a while, what's a good way for them to react to seeing an activist come in?

Dave [00:12:47]:

I think you have to take it in context with the performance of the company at that particular time. To your point, when Elliot came into PayPal, they were on the struggle bus, and Elliot saw an opportunity to come in and try to turn the tide on what has been going on with PayPal and forcing them to make changes that the management was not willing to make. And in a lot of cases, the board was not willing to make. And by them coming in, it forced the company to start making some changes. And we'll see over time whether those changes will prove worthwhile or not. At this point, it's too early to tell, but in that circumstance, I was happy about it because I wanted to see the changes. You got two choices. When things are not going well, you can keep doing what you're doing, or you can try to pivot.

Dave [00:13:47]:

And I think continuing. What's the definition of insanity? Doing the same thing over and over again and expecting a different result. Kind of the same with business. And I think when you're thinking about a company that you own and you see an activist come in, I think you really have to take it for where the company is and how well they're doing. If a company is doing really well and an activist comes in and then they want to start making a lot of changes, then I would probably vote with my feet and bow out, because if they get power, let me rephrase that. If they get power and they start enabling some of the changes that I don't agree with, then I would probably be out. But that's how I would try to, I guess, try to look at it from a higher level overview. What about you?

Andrew [00:14:34]:

Yeah, I think it is case by case, unfortunately. It's been interesting with this most recent one, because it opens your eyes to the way that people on Wall street might view a stock. And to your point, sometimes you keep doing what you're doing when you have adversity, and sometimes you pivot, and sometimes doing what you're doing is the right answer, and sometimes pivoting is the right answer. So there is no easy blanket statement to say yes, good, bad, no. So I would refrain from making any generalizations as well. Like you, what would be some of the downsides then to activists coming in?

Dave [00:15:28]:

Well, I think if again, well, let me back up for a second. I think one of the things that there are some activist investors that I think probably fall under the guise of what you would call a corporate radar, where they come in and they basically try to take over the business and in essence break it up to try to extract the most value that they can and then move on to the next thing. And so they're not really interested in the long term returns of the business or the shareholders. It's more about their immediate need to try to get a good return on investment in a shorter amount of time. And so if you find those kinds of firms, I guess, are attacking or trying to get into, worm their way into your company, then I would be concerned because that could be a potential downside. If you have a company like, let's just say Microsoft that's running, hitting on all cylinders and is doing awesome things, and all of a sudden a corporate raider gets into a company like that, decides to break off azure and break off office and all these things, well, that may extract some short term value for the activist investors and the current shareholders. But if you are looking to partake in the business performance of Microsoft for the next ten years, then to me that would be a big downside. And so I think I would have to look at what kind of activist investor is coming in and what are their plans to do things.

Dave [00:17:11]:

One of the, I guess the advantages to the way things work today with social media and with the Internet, and you can fairly easily, not fairly easily, you can fairly quickly figure out what they're trying to do because a lot of times they're trying to sway people to their side. So they're going to broadcast their intentions to try to hurry favor so that it makes their case stronger. So in the case of Elliot, for example, they're putting out blog posts. They started their own website with what they're trying to do. What was the title for the blog post for the crown Castle one?

Andrew [00:17:56]:

Restoringthecastle.com.

Dave [00:17:58]:

Right. Restoringthecastle.com. So that is a great broadcast of what they're trying to do. And so if you don't know what Elliott is trying to do when you read some news or see it on CNNBC or something, you can go know, restorethecastle.com and learn all about it. So I think that, to me, is one of the great advantages to our time, is that it's not a secret because they're trying to curry favor so they can get a board in the seat, so they can do what they need to do. But different activists will do different things, and they may function a little bit different. And so to go back to those corporators, I'm not intimate to all of Bill Ackman's activist activities in the past, but I know there was a couple of companies where he forced his way onto the board and then tried to split up the company, but he got a lot of pushback from shareholders and the board members and the CEO. And so he ended up actually kind of bailing on that investment, because.

Andrew [00:19:01]:

I'm.

Dave [00:19:01]:

Hoping, I'd like to think they had a change of heart or a change of mind, that maybe, hey, what I wanted intended to do is maybe not going to be the best thing. And so he changed his mind and got out, but his intention was to break up the company. And so I think depending on what you know about the activists and how they have reacted in the past, I think can tell you a lot about what could be the upsides and the downsides, to me would be them destroying value in the business. Just because they get a board seat doesn't mean they always know the best about the business because they haven't run it. And so it doesn't mean that their idea is automatically the best idea. And sometimes change for change sake is not always the best. Yeah.

Andrew [00:19:49]:

I mean, imagine if somebody on the board told Elon, hey, you got to scrap this model three thing. It's not profitable fast, right? Sometimes you need a visionary, right?

Dave [00:20:00]:

Yeah, for sure.

Speaker C [00:20:03]:

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Andrew [00:20:14]:

What's interesting about the Acman thing is he used to be a lot more active than he is now. I mean, at least when he recently did a stake in Domino's, he said this was going to be a passive stake, and he came out pretty quickly. But it is interesting to kind of see that and the different ways that different big name investors have done it. You could argue Warren Buffett kind of was a corporate raider to Berkshire, and that's how he got Berkshire. Right? Yeah. Did you know Benjamin Graham, also one of his very first investments? He was doing something similar.

Dave [00:20:51]:

No, I did not know that.

Andrew [00:20:54]:

It wasn't to raid the company or take it for himself, but he thought that the company was sitting on too much cash, and he wanted them to pay it out as a dividend. And so he went to the board meetings and raised a fuss, and then they laughed him out of the room and this and that. It's interesting to see that a lot of the names that we know kind of have made their way in one way or the other, being directly involved in some of their.

Dave [00:21:25]:

Exactly. Well, you know, even Berkshire has been a target for some of that know, people wanting Charlie and Warren to step down from being the board members of the company that they're running. And they feel like that there were better opportunities in the company. And Berkshire, to your point, sits on a lot of cash, and there are some investors out there that think that that either should be given back to shareholders as a dividend, or they should be more aggressive about buying back shares or they should be more aggressive about buying other businesses. And Warren has resisted that to this point. You can't really argue with his think. You know, it's. It's always interesting to know everybody has an opinion, and it's always interesting to see what ideas can come from different things.

Dave [00:22:18]:

But it is interesting that Bill Ackman. Yeah, he was far more active when he was younger, and he seems to have kind of faded from that.

Andrew [00:22:27]:

Yeah. A little more hands think. You know, for me, we'll see how this plays out with my investment. I think there's been some good things proposed. I think there's other things that maybe I question. So it'll be interesting to see how this plays out. But if there's really two big points that I would try to take away from it, I would say, number one, if you are investing in a company that is majority owned and it has majority of the voting power, you won't see this happen. And so that's a risk you take, is that you are putting your full faith in management in that situation.

Andrew [00:23:11]:

You're putting your full faith in the majority owner in that situation. Not to say it's a bad thing, I have my own majority investments, too, but that is something to consider. And then the second thing I would say is, I think it really shows how that quote from either Charlie or Warren find a business that's so simple to run because that an idiot can run it because one day somebody will not saying that every activist situation has a CEO who's incompetent, but in the chance that you do run into those problems, like to use your example about know, for whatever reason, Satya decided to retire and know Bimbo came in or whatever ham sandwich and tried to shake things up. At some point, maybe you would hope an activist would come in and kind of restore things to where it was. And so by looking at the basics of a business, its competitive advantage, why is this business so different and so structurally better than other businesses? It can save you from a lot of this anguish to know that even if somebody doesn't know what they're doing is coming in, either the board is going to see it or maybe an activist can come in and fix things. So to me, as a long term shareholder, I feel better about buying stocks when I know that that's a feature of stocks in general.

Dave [00:24:40]:

So would you say that buying companies that are founder led or founder owned are better?

Andrew [00:24:51]:

What do you say? I know what Twitter would say.

Dave [00:24:56]:

Yeah, I know what Twitter would say. Twitter would say, absolutely. But I think it depends. I hate to qualify it like that, but I think there are certain companies that do better based on the person leading the bus. So I don't think Tesla would be Tesla without Elon Musk. And if you remove him from the equation, at some point they'll have to, because know either retire or pass on and how well the company does beyond that will know how well he's built the business. But I think you look at that, you look at Amazon and Jeff Bezos time at Amazon, you could argue that that company would not be what it is without him doing it. But then there's other companies know.

Dave [00:25:50]:

I'm struggling to think of anybody that know Steve Jobs was obviously very instrumental, but Tim Cook has just been equally instrumental in Apple's success. Sati Nadella has been very instrumental in Microsoft success since he took over. But you could argue maybe that Sundar Pinchai, who's running Google, maybe hasn't been as integral to the success of Google. I don't know enough about him and his impact on the company to say yay or nay, for sure, but I feel like maybe not so much where you look at Slash Facebook, it wouldn't be where it is without there's, I think the cult of personality kinds of companies can certainly benefit from having those people. But I think the success of it's going to be interesting to know. Steve Jobs did a good job of setting up Apple so they could succeed with another manager running the company. Tim Cook has obviously done a fantastic job and it'll be interesting to see once he steps down how the company continues to perform. But Amazon, I think there was a lot of questions about whether Andy Jassey could get the job done after Bezos stepped down, and they staggered a little bit at the beginning of his tenure, but now they seem to be finding their feet and doing.

Dave [00:27:21]:

I, I guess I'm a little torn on the whole idea. I think it really depends on the company.

Andrew [00:27:32]:

It's tough when you're judged on how your stock price does. Right. I'm not going to name names, but a company that I know, a guy comes in and return on equity goes up year after year after year, but the stock price doesn't follow, and now there's outrage. Right, right. I remember when one of the ceos you're just talking about was actually, well, revered and considered one of the great leaders, and now the stock hasn't done well. And it's almost like, what's he done for the business lately?

Dave [00:28:02]:

Right.

Andrew [00:28:03]:

It's definitely a tough place to be in if that's what you're banking on. And I think that's where it helps to be a rational investor and try to separate what's going on with the business, with what's going on with the stock price. I agree with you. I think you do have to take it case by case again.

Dave [00:28:30]:

Right? Yeah, for sure. I think the way that I would try to frame it is look for the best business that you can, and if you have a great CEO that's running the business, then that's even better just because that's kind of the best of both worlds. I think if you look at a company like, you look at a company like Visa, they have been a fantastic business for a very long time, and they've been through four or five ceos since Dhawk took over, and the company just continues to excel. And is that based on the ceos or is that based on the company? I would probably argue that it's probably more on the business than it is, particularly on the ceos, because they really haven't done a lot drastically since the company was founded. And so I'm not saying that the people that are running it are inept or incompetent, far from it. But I guess what I am saying, they're not founder led companies, but they're still fantastic businesses.

Andrew [00:29:35]:

Yeah. How do we get a job? Like, don't. You don't tip over the apple cart, right?

Dave [00:29:41]:

Yeah. Just don't screw this up. You got a great thing here. Just do not screw it up.

Andrew [00:29:50]:

Any last thoughts on activist investing and how investors should think about it?

Dave [00:29:57]:

I think the thing you need to really kind of understand, I guess you need to understand what the activists are intending to do, what they're trying to do what their goal is and kind of what position the company is in and why they're taking a stake. They're only taking a stake if they feel like they can enact change that will benefit them and their return on their investment. And you're really only going to find this if companies are in distress. And so if everything is super successful, you're probably going to find less activism involved. But when companies are struggling a little bit or they're in that sector that's struggling, then you might see more of that. And I think you just have to take it case by case and understand who it is that's coming in and trying to do what they're trying to do. And in some cases, it will be exactly what you want. In other cases, it may not be.

Dave [00:30:53]:

And so then you can make a decision from there. What are your thoughts?

Andrew [00:30:57]:

Yeah, I think it's fascinating. I love this part of the market and investing, and it's funny to see how fast change can happen. Spoiler alert, Crown Castle CEO is moving. So that was very fast. I mean, the activists came in, and within weeks, the CEO is. Yeah, I have nothing else to.

Dave [00:31:21]:

Yep. All right, Charlie. All right. Well, with that, we will go ahead and wrap up our conversation for today. If you have any burning questions, if you're something you're dying to know, please reach out to us. We'd love to help you. We'd love to answer the question on the air. You can send your questions to newsletter@einvestingforbeganners.com you can also go to Spotify.

Dave [00:31:43]:

They have an area that you can ask questions on the app as well. So those are two great ways. You can also reach out to me at Twitter, at IFB, Underscore podcast, and you can ask me questions there as well. So there's lots of great ways to reach out to us. If you have something, I need to know this, and we're here to help. So with that, we'll go ahead and sign us off. You guys go out there and invest with a margin of safety. Emphasis on safety.

Dave [00:32:07]:

Have a great week, and we'll talk to you all next week.