NEUBERGER | BERMAN

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What Active Engagement Looks Like

Resolution of the Ashland proxy dispute displayed the power of an owner's long-term perspective and commitment.

At Neuberger Berman, we like to say that we act as owners, not holders, of the companies we invest in for clients. This means that we take an active interest in the long-term prospects of their businesses, and engage with them in order to encourage best practices and maximize value for stockholders and bondholders. In our new Engagement Series, we present case studies on our engagements with invested companies. Senior Portfolio Manager Charles Kantor is our first columnist.

Over the course of a given year, the vast majority of our engagement efforts typically take place outside of the public eye. However, in the recent case of Ashland Global Holdings Inc., we took a very public stance to help resolve a disputed proxy. It was a situation that I believe illustrates the power of active engagement in seeking to preserve and grow clients' precious capital.

Ashland has been a part of Neuberger Berman portfolios since 2012. We were attracted to Ashland originally in light of its potential for transformation—from a collection of cyclical, largely commoditized businesses to a higher-margin, true specialty chemical company. Over that time, we were not shy in sharing our opinions (either as a firm or as individual analysts and portfolio managers) about ways to make this path smoother and more rewarding for shareholders.

Within Neuberger's Kantor Group, our approach to such interactions, regardless of the company, tends to focus on four areas that are of incredible importance to us:

- **Capital allocation:** We want to make sure that the company's scarcest resource, its cash flow, is allocated to create long-term value; not to create bigger, more complex companies, but more strategic ones, with the potential to eventually realize returns for the risks being taken.
- **Corporate governance:** We want to make sure board members are truly engaged, and that they take seriously their primary responsibility of selecting the CEO and making sure he or she is making appropriate capital allocation decisions.

- **Incentive compensation:** Unfortunately, pay models in the corporate world have moved almost exclusively toward competitive pay structures rather than performance-based measures. We work to influence management teams and boards to set better long-term incentive metrics—typically cash-flow and returns-based rather than earnings-based.
- **Financial communication:** We believe that communication should be a real corporate strategy, and that companies get the shareholders they deserve. Thus, we encourage a focus on "key performance indicators" rather than specific quantitative metrics, and steadily paced financial guidance with wider ranges to encourage interest from longer-term owners.

New Developments Accelerate Engagement

Although generally pleased with the progress at Ashland, we grew more concerned about capital allocation with its 2017 purchase of a nutraceutical and fragrance ingredients producer, something we felt was inconsistent with the previously announced goal of moving toward a less complex business. A group from Neuberger Berman, including our lead chemical analyst, met privately with the company. Although we were direct with them regarding our concerns, we decided to "hold fire" and give Ashland management additional time, while monitoring the situation vigorously.

In the months that followed, activist investor Cruiser Capital was vocal in calling for change at Ashland. For some time, they had been proposing reforms largely around operational execution and efficiency, but became impatient with the response they were receiving. They began a proxy fight late last year, calling for four new directors to be placed on the board, among other demands.

This development fundamentally changed our stance on engagement with the company. In our view, a protracted proxy battle could prove very distracting and could potentially increase the risk of a suboptimal outcome. Given the company's large passive investor base, our assessment was that the leading proxy advisor firms were set to decide the makeup of the boardroom, but were unlikely to agree to more than one proposed director. We believed that a separate agreement between Ashland and us could lead to better results for all stakeholders.

Consequently, we told management we were willing to support them in the proxy fight, in return for certain conditions, and we ultimately agreed on the following:

- The retirement of their lead director (who was already beyond the company's official retirement age)
- The addition of three new board members, two of whom would only be approved with the mutual agreement of the company and Neuberger Berman
- The naming of a new lead independent director
- The creation of a new subcommittee on capital allocation, which we believed was very important in light of the $1 billion proceeds they would soon receive from the sale of a commodity business
- The appointment of new heads of their compensation, and nominating and governance committees
- The reintroduction of return on capital as the key metric in long-term incentive plans

Admittedly, the one weakness in our proposal was that the timeframe from our engagement until the annual meeting in February did not allow us to identify the potential board nominees beforehand—something that Cruiser initially objected to upon learning of the plan. However, an advantage was that joint approval would provide more credibility to the selections, and allow us to tap into our extensive network, which has since proved invaluable in the search process. With the company's offer to hire a special consultant for six months, Cruiser ultimately signed on. In the end, more than 95% of shareholders approved the plan.

We did not get everything we had wanted. Our original ask included separating the chairman and CEO functions, a division which we thought would make more sense for compensation and evaluation purposes. However, with the broader mix of changes, we believed this particular issue became less urgent and, as a result, we did not press the point. Looking back, I would say we conducted a negotiation in the true sense of the word, with compromise enabling a positive outcome that multiple parties could feel good about. Most importantly, the agreement provided what we consider to be attractive potential benefits to long-term shareholders.

Growing Importance of Engagement

Looking ahead, the ability to actively engage with companies is likely to become increasingly important. In a world where 20% to 25% of a given stock's shareholder base may be passive, it falls to a smaller number of active managers to encourage companies to improve, and to hold them accountable when they do not. At Neuberger Berman, I feel we are well positioned to assume this role given our patient perspective and the ability to use all the tools at our disposal to maximize long-term value. Over the coming months, we will be conducting calls and meetings with many companies to learn about their progress on strategic goals and then offer our own perspective on ways they can strengthen their businesses and deliver for shareholders. Engagement is not a "one-off"; rather, it is an integral part of our ongoing investment diligence and fiduciary responsibility to clients.

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