NEUBERGER | BERMAN

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Using Our Voice in Value Investing

Constructive relationships and a long-term perspective can open doors when engaging with companies and other shareholders.

Neuberger Berman's *Engagement Series* presents insights and case studies on our dialogue with companies, government entities and other securities issuers. In this column, Benjamin H. Nahum, portfolio manager for our Intrinsic Value team, discusses the special importance of engagement for value investors.

The impact of corporate engagement often depends on the investor. A momentum-driven growth manager may care more about shorter-term factors that affect earnings or stock price than about board makeup, compensation structure or capital allocation. The formula is quite different for a value portfolio manager, who may look beyond fundamental analysis to engagement in order to improve performance. The Intrinsic Value team at Neuberger Berman has found that our engagement, whether in private or public, can be a very effective investment tool.

Historically, high-profile engagements were not the realm of traditional managers, and were typically left to activists with social agendas or corporate raiders with short time horizons. With the growing attention to environmental, social and governance factors, however, activism has become more mainstream, and long-term-oriented active managers have come to realize that we can be particularly well positioned to drive corporate and strategic change at portfolio companies.

Credibility and Measured Action

The reason is credibility. Here at Neuberger Berman, our portfolio managers are not driven by incentive fees, but rather seek to invest in companies over a number of years based on fundamental considerations. As a result, managements tend to be far more receptive to our suggestions than they might an activist who buys a 5% position and immediately starts demanding layoffs, restructuring or special dividends.

In general, the Intrinsic Value team's approach is low key, taking opportunities to share good-faith ideas based on our analysis of their businesses, competitive positions and the overall markets in which they operate. In many cases, such consistent, private dialogue leads to meaningful reform and value creation. Still, we understand that, at times, more forceful measures may be required. That can lead to public letter writing and, eventually, proxy contests—in which we can present our views in the "public square" to shareholders at large. Our willingness to cross that Rubicon helps recalcitrant companies take us seriously, as our seven engagements with boards of public companies, two of which have resulted in proxy fights, have shown over the past decade.

At what point, you may ask, will we consider moving from private discussions or letter writing to a proxy contest? In terms of ground rules, our team will generally only take action if a stock represents a substantial position—i.e., more than 2% of our portfolio—and only if we have held the stock for a meaningful time period; under one year does not meet the threshold.

Beyond these guidelines, we will move into "activist mode" if quieter dialogue has not worked, and management, despite many opportunities to do so, has not responded sufficiently to what we believe are legitimate concerns.

Engagement With Verint

Our engagement last year with Verint Systems Inc. provides a telling example of our process. We originally purchased the company in 2006, on the strength of its powerful technology and presence in both corporate call centers and cybersecurity systems. Although recognizing the company's potential, we became concerned about its frequent acquisitions, and insistence on maintaining the two very distinct businesses. Within its call center business, we worried that Verint was not moving fast enough toward the cloud-based model that was gaining traction in the industry. We also had issues with corporate governance and a lack of detail in financial disclosures.

To its credit, the company agreed in 2016 to our recommendation of a new board member—the first woman on the board and someone who provided needed technology and corporate structure expertise. However, the rest of the board remained long-tenured and dominated by individuals who, while distinguished in their fields, lacked pertinent expertise to guide the company in a rapidly changing environment.

Over time, our recommendations for new board members and added disclosures—particularly widely adopted cloud statistics—were brushed aside. Additionally, we remained concerned that the company's revenue-based compensation formulas rewarded growth with limited regard for profitability or strategic direction. Ultimately, it was management's inconsistent signals on capital allocation and an extended period of weak stock performance that led us to take action. In May 2019, we filed a proxy statement seeking the substitution of three new board members and a series of new disclosures to make analyzing the company more feasible.

Although the company's initial response was vocal opposition—in which it pledged to spend several million dollars to fight our initiative—our approach eventually worked, and we were able to sit down and discuss our issues in a meaningful way. Although we withdrew our board slate, we secured management's agreement to institute measurable financial targets, as well as to consider more seriously our strategic and governance concerns. Seeing the same value opportunities as we did, a distinguished private equity firm, Apax Partners, has since invested $400 million in Verint and secured two additional board seats to help accelerate its corporate transformation. In December 2019, the company announced that it would spin off its cybersecurity business in a public offering.[1] We continue to hold Verint.

[1] "Verint Announces Plan to Separate Into Two Independent Publicly Traded Companies," December 4, 2019, www.verint.com.

Using Our Voice

For us, the lesson here is that engagement and activism can be effective—particularly for value investors. In our world, we often traffic in companies that are trying to correct for issues that they have not yet figured out, which has historically led to depressed stock valuations. To make a given situation work for us, we need confidence that improvements in financial position and/or strategic direction are likely to emerge—however, that won't happen in a vacuum.

As a long-term investor without incentive fees, Neuberger Berman carries a certain level of credibility that encourages management to pay attention. It makes for very fruitful dialogue and meaningful influence. However, if they don't respond, we are more than willing to use our platform to raise issues around value creation that will resonate with shareholders and potentially benefit our clients.

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