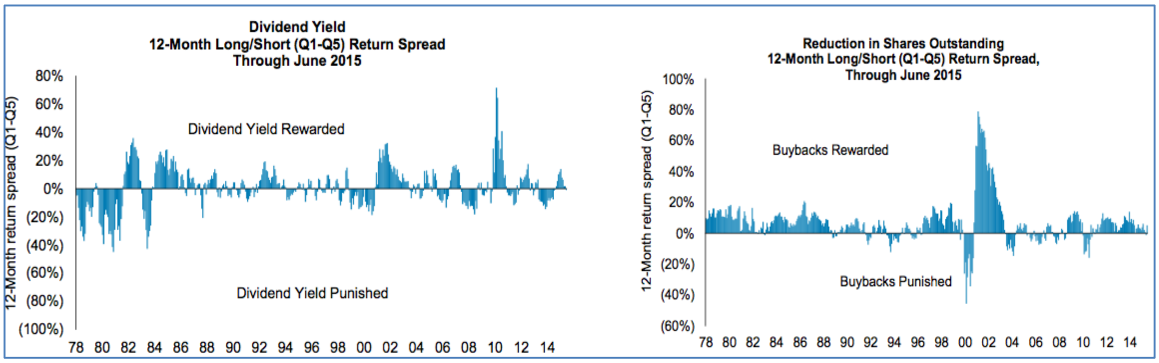
Tiburon Capital Management

Shark Bites Volume 5 Article 5 August, 2015

"Quarterly Capitalism" and Appropriate Corporate Stewardship

We've often noted the importance of dividend payouts as part of the historical total return of equities. Since 2010, we've discussed the twin shareholder-friendly activities of dividend initiation/increase and share buybacks as a tailwind to share price given company uses of cash while we await plausible *Revaluation Catalysts*. The favorable impact on total return is not easily denied. Further, proper and enlightened corporate stewardship requires than managements consider Return on Invested Capital ("ROIC") when determining cash uses. Arguably a rigorously derived ROIC cash use is in the best short term and long term interest of the company as a franchise, its management as fiduciaries and its shareholders as owners. Forging this growing connectedness of corporate and shareholder objectives through appropriate management compensation rounds out the equation.

Dividends and Share Buybacks Both Effective in Recent Years



Source: Morgan Stanley Research

Harkening back to our high-minded sounding *Social Contract*[1] theme: All's good in the land of properly allocated capital. Wait, well, better said: all's good for long positions where such shareholder-friendly activities occur. The nuance of this is that what is good for share price (and some shareholders) near-term, is not necessarily in the longer-term interests of the corporate franchise or other shareholders. This is not really our fight, nor relevant to deriving returns in the here and now. Our investment management business is not a bully pulpit from which to propound a political or social point of view – our mandate is to make our clients money. But there has been some recent debate on this topic worth noting (and parsing for the failings) as it is bound to continue and increase in the public consciousness.

Hillary Clinton's speech at NYU on July 24th reawakened the debate over executive compensation and the coincidence of shareholder-friendly behaviors. Clinton derided what she called "Quarterly Capitalism"[2] – the alleged tendency of managements of public companies to act in the short-term interest of *speculators* rather than the long-term interest of *more patient investors* and the broader economy. A year ago, Laurence Fink of *BlackRock* penned a letter to *Fortune 500* CEOs expressing his concern that "in the wake of the financial crisis, many companies have shied away from investing in the future growth of their companies," choosing instead to reduce capital expenditures in favor of higher dividends and increased stock buybacks. Such decisions, Mr. Fink warned, can "jeopardize a company's ability to generate sustainable long-term returns." I think as interested parties (something we always consider, by methodology), you can question the motives of both Ms. Clinton and Mr. Fink.

We will not put this debate to bed here. We've written a lot on the topic of shareholder-friendly activities and activism for that matter (and it coincidental rise in popularity with shareholder-friendly activities, rather that precipitating them).[3] While we do not disagree with Mr. Fink regarding uses broadly, the issue is defused by

---

[1] See *The Seismic Shift towards a New Corporate Social Contract*, Lupoff, Shark Bites Volume 4, Article 1, September, 2013.
http://www.tiburonholdings.net/uploads/The_Seismic_Shift_towards_a_New_Corporate_Social_Contract_Final.pdf

[2] *Quarterly Capitalism* as a concept was first discussed Bill Clinton's administration in the early 1990s.

[3] See *The Coincidence of Activism and Shareholder-Friendly Corporate Activities*, Lupoff. Shark Bites, Volume 5, Article 4 June, 2015.
http://www.tiburonholdings.net/uploads/Shark_Bites_-_Activism_0615.pdf

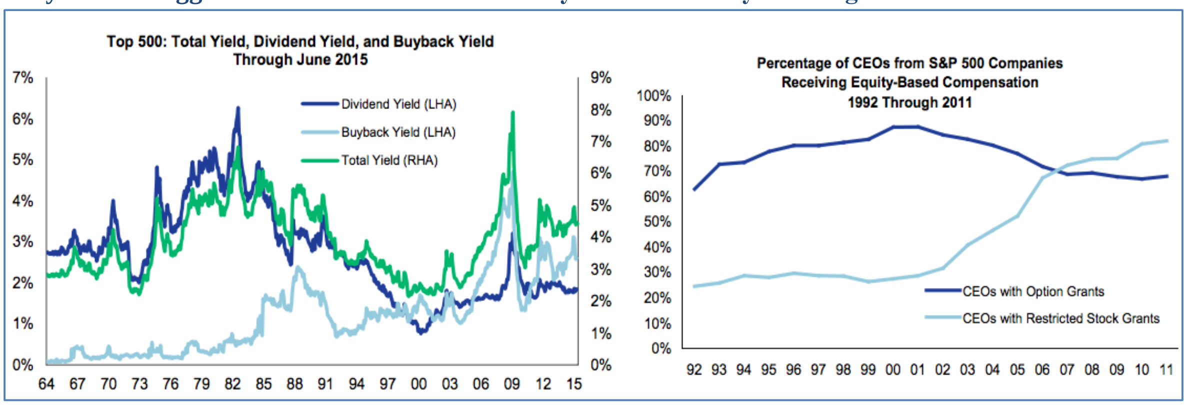
tying executive compensation to ROIC and paying management for current work, shorter-term and longer-term performance. Longer-term performance should be the lion's share of pay and be in the form of equity (not cash or options).

Bloomberg points out that the inclusion of Earnings per Share or total shareholder return in CEO pay is above average for 11 of the 15 companies that spent the most on buybacks in 2014.[4] The entire debate about *Quarterly Capitalism* is moot, then, if decisions are perceived to be derived from ROIC calculations, with compensation ramifications for management largely longer-term, in equity (and restricted and locked up, better yet). Management can suck, but that's another story, another debate and idiosyncratic to the company, not systemic.

The notion that reasonable and longer-term investors don't want heightened returns in the nearer-term if they are better risk-adjusted returns, is naïve (or worse, knowingly wrong-headed). Further, a view that somehow activists or speculators never, or don't coincidently actually have it right on most occasions, is myopic.

Hillary Clinton has opened a debate; she has by no means ended it. As the campaign progresses, she and other candidates will have the opportunity to expand upon the debate, however, in likely uninformed and one-sided ways.

Buybacks a Bigger Part of Total Return Recently…But CEO Pay Skewing Toward Restricted Stock



Source: Bloomberg

Peter M. Lupoff **August, 2015** **Tiburon Capital Management, LLC**

Tiburon Capital Management, LLC

1345 Avenue of the Americas 3rd floor

New York, NY 10105

646.840.4925

www.tiburonholdings.net

[4] *Bloomberg*, July 7, 2015