Insight

PRINCIPLES OF LONG-TERM SHAREHOLDING:

ACTIVE OWNERSHIP, NOT ACTIVISM

The Stern family's core conviction has been to invest based on principles that Maurice Stern established in New York after escaping the German occupation of Paris: to invest in global companies that can offer quality and value over the long-term.

For a historic banking family that had prospered by financing companies and governments, including establishing banks that are known today as BNP Paribas in France, Deutsche Bank in Germany, Banamex in Mexico or Garanti Bank in Turkey, throughout the 19th and early 20th centuries, the decision to invest its wealth in public markets was a significant step. It may have been born out of necessity. It certainly benefitted from the prudence and foresight of having capital in different places. But mostly it was a recognition of the need to adapt to historical upheaval, changing circumstances and new opportunities. Building on the lessons of the past, but adapting for the future is why Maurice Stern kept the family's investments in shares when he returned to France to rebuild the bank and it is why the family has maintained that approach since then.

Today, J. Stern & Co. represents the sixth generation of the family. The family office has moved from Paris to Geneva and now to London and Zurich. Our investment approach is based on the same principles and adapted for the circumstances and opportunities we see today.

Quality is the prime consideration. It means that we look to invest in companies that are global leaders, have strong competitive positions in good and growing markets, have management teams with strong records of value creation and robust balance sheets. Value means buying those companies at prices that allow for the prospect of significant capital growth over 5-10 years or more.

We continue to believe that investing in global leaders is an optimal way to profit from the growth in their businesses and their value creation while diversifying risks. Most if not all of our global leaders are large and liquid companies listed on established markets in the US and in Europe. They have broad geographic reach, their revenues and costs are in many different countries and currencies, and they undertake their own hedging of risks from fluctuations in exchange rates, interest rates, commodities, energy prices and other sources.

We have adapted our view of quality to seize the opportunities we see today. Companies in businesses like consumer goods and healthcare have been in family portfolios for decades. They benefit from underlying growth in demand as their customers grow in number, age, incomes, expectations and aspirations. They have pricing power and operating leverage because of their scale. They can also grow because of their investment in new products, new markets, innovation and research and development.

We have added investments in companies that are part of one of the greatest opportunities we see today, the digital transformation of our world. These companies have leading positions in businesses like online search, e-commerce, cloud computing, image software, digital marketing, online gaming, online hotel bookings and other businesses. We believe they are at a similar point in their development as consumer and luxury goods companies were 25 years ago. There are a number of recognized leaders, they have done well and in some cases very well for investors, but they are still only at the beginning of their value creation.

That is why another of our core principles is active ownership. We are long-term shareholders of businesses. We think and act like principals, not agents. We look for good management and we often like businesses that are owned and controlled by their founders, their families, or by controlling shareholders, where their interests are aligned with ours and where the corporate governance means that our rights are protected if need be.

We are rarely ask about quarterly earnings and other short-term issues. We are focused on the long-term, on competitive advantage, innovation, investment and capital allocation. In many cases we have long relationships with managements. Our long investment means that in some cases we were part of discussions about capital allocation and other issues decades ago, including in some of our longest-standing and largest investments, and can offer our perspectives, insights and suggestions about current corporate decisions and actions.

As active shareholders, we will of course express our views if we disagree, and we will defend our interests forcefully and publicly if necessary, as we did in the case of Sika as can be seen in the public record.

We were asked recently about our reaction to activism by a large hedge fund against Pernod Ricard, a long-term position in our portfolios, which echoes a similar activism by another hedge fund against Nestle last year. As you can see in the article in *Institutional Investor*, we felt it was important to share our position with other long-term shareholders of the company.

We do not believe in activism in the form that it is practised so often today, where funds and hedge funds take positions in the short-term, often through derivatives (an "economic interest" in a company, not shares) that imply a limited and leveraged investment by their nature and their costs, and engage in letter writing campaigns to drive companies into corporate actions. Invariably these letters do not address long-term strategic issues or investment but call for cost cutting, divestitures, spin-offs, increase in debt and share buy backs.

These things are easy to do, they are all part of appropriate capital allocation and are done by most, if not all the companies we invest in. Both Nestle and Pernod certainly have strong records of capital allocation, investment, growth and value creation, in each case supported by the long-term nature of their shareholders, whether institutional and family offices as in the case of Nestle due to its history and size or the Ricard family in the case of Pernod. We have strong views on them and discuss them with management. But they are not what generates value over time. That is the hard part, and it takes us back to the principles of quality and value, and of benefitting from the long-term compounding of returns.

Of course, as we said, any shareholders are to be welcomed and it cannot hurt to urge companies, their boards and managements to take the right decisions. In the way it is practised in these examples, however, it is tiresome and pointless, and it risks distraction if media, research analysts and institutional investors climb on the bandwagon for their own short-term reasons, whether to generate clicks on articles, changing recommendations and trades, or short-term, often year-end outperformance, performance fees and bonuses in absolute or benchmark terms. None of these have to do with investment.

We have been shareholders of Nestle and Pernod Ricard long before the activist hedge funds showed up and we expect to be shareholders long after they move on to their next target. That is why we think it is important for active shareholders to support managements of companies from time to time, and why we will make public statements from time to time to take a stand.

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PORTFOLIO

Investment Firms Push Back on Elliott Management's Pernod Ricard Campaign

Shareholders J. Stern & Co. and Groupe Bruxelles Lambert are voicing their support for the French spirits company.

Alicia McElhaney

Investment firms J. Stern & Co. and Groupe Bruxelles Lambert are pushing back against Elliott Management Corp.'s activist campaign targeting French spirits company Pernod Ricard.

The two shareholders are voicing their support for Pernod Ricard following Elliott's announcement this week that it owns a more than 2.5 percent stake in the company. The hedge fund firm, founded by president Paul Singer, is agitating for change.

"It is tiresome to hear activists push good companies to do more of what they are doing all along," said Christopher Rossbach, chief investment officer of J. Stern, in an emailed statement Thursday. GBL, which says on its website that it owns about 7.5 percent of Pernod Ricard, echoed his confidence in the company's current strategy.

GBL "fully supports the family values of Pernod Ricard based on long-term value creation," a spokesman for the investment firm said in an emailed statement Thursday. The spirts company's strategic plan, as well as its share price, reinforce its faith in its investment, he said.

Elliott is pushing for Pernod Ricard, which owns the Jameson Irish whiskey and Absolut vodka brands, to add independent directors to its board and to engage in more rigorous cost-cutting measures.

According to Elliott, Pernod has been underperforming its peers, particularly Diageo, the British brand that owns Smirnoff and Baileys. Elliott said in its announcement that Pernod's operating margin is at a five-percentage-point discount to Diageo, its closest peer.

But J. Stern likes what the company has delivered so far.

"Pernod has generated total returns of 9 percent per year over the past ten years, 14 percent per year over the past twenty years, and 12 percent per year over the past twenty-five years," Rossbach claimed in his statement. "That is a strong record of value creation for long-term shareholders like us."

Rossbach compared Elliott's campaign to Third Point's activist campaign against Nestle, which launched in 2017. J. Stern also holds a stake in Nestle.

"Third Point has been 'demanding' that Nestle grow faster, control its costs and allocate its capital more efficiently, all things that Nestle's management has a strong record of doing for decades," Rossbach said. "Elliott's demands of Pernod Ricard are the same."

Third Point or Elliott showed up" and that the firm will stay invested in both for a long time after they divest.

A spokesperson for Elliott did not respond to an email seeking comment. A spokesperson for Pernod Ricard declined to comment.

Christopher Rossbach
December 2018