Corporate Governance: Spring 2014 review

It is clear that the time horizons of investors have continued to shrink. We know that the turnover of shares is at multi-decade highs. We know that high frequency traders have come to dominate markets. We know that most hedge funds are dominated by traders rather than investors. Yet, increasingly, what concerns us is the skew of standard fund management towards the same mentality. Even when stocks are in a portfolio, they are rented more often than they are owned. It can hardly be a surprise if company management either ignore such a shareholder base or exploit it to seek reward.

The single most encouraging feature of what we have experienced in LTGG over the past decade has been the strength and depth of the relationships we have forged with companies. We have proven to management that we really are long-term investors with an interest in their cultures and competitive advantages. We are also patient and accepting of long-term visions not short-term pressures. This has resulted in influence and access that is perhaps disproportionate to our size.

Since management vision and motivation are central to the appeal of any company as an investment, we believe the individuals selecting the stocks should engage directly with company management. If management themselves do not adhere to the stated vision or act as long-term guarantors of that vision, then we must address the issue. This is not to suggest that we involve ourselves in micro-management. We endeavour to balance our involvement and firmness with a real willingness to support managements that live up to their words in awkward circumstances.

In this spirit, we were delighted to back Illumina management against Roche's opportunistic bid – despite the near certainty that this would lead to an immediate decline in the share price. Illumina is a truly innovative company. As genomics embeds itself into medicine and everyday life, the opportunity for Illumina expands. As long-term investors, we were not willing to give up on the company or the opportunity simply because Roche was offering a premium to Illumina's so called 'distressed' valuation. Since the successful rejection of the Roche bid, the share price has grown to more than three times that of Roche's offer, but more importantly we have seen significant operational developments at the company and an improved political backdrop; the recent US government funded study into newborn babies would have been unthinkable even three years ago. Furthermore, the study of genomics is no longer confined to academic and government funded projects, but has increasing backing from corporates, which surely signals the value of this data to commerce.

Last year, we engaged with eBay's management in relation to the executives' compensation policy as, during the year, the company had made special one-off awards which we believed were inappropriate. We had concerns regarding the vesting and performance conditions attached to the long-term incentive plan (LTIP) and the one-off retention awards granted during the year to CEO John Donahoe ($14.9m) and CFO Robert Swan ($6m). We are generally opposed to these types of special awards as they undermine the existing compensation policy and there is limited evidence to support their ability to effectively retain management or align their interests with shareholders. An overwhelming 40% of shareholders opposed the resolution and, following further engagement, we have seen a change in stance on pay this year – a positive improvement. Our conversations with management have now turned to PayPal and its potential spin-off. Management are opposed to the spin-off and we are happy to back them, but we have also spoken to Carl Icahn to get the other side of the argument.

There has been considerable change at Burberry with the departure of both CEO and CFO. The loss of a visionary leader in CEO, Angela Ahrendts gave us cause for concern and we have been in communication with management following the announcement of her resignation. Christopher Bailey will now take on the mantle of CEO alongside his responsibilities as Creative Director. Our discussions with management are ongoing and in particular we are focusing on Bailey's combined role and the apparent change in strategy as the company moves into beauty. Our concern is that Bailey will be spreading himself too thinly and that the move into beauty is a Bailey-led change of strategy which puts less weight on capital discipline. The lines of communication remain open; we hope that we can build a good relationship and so long as Bailey's actions and vision for the company are aligned with the interests of shareholders, we will be supportive.

Over the years, we have tried to build strong relationships with the management teams of your holdings. It is often the case that their insights offer a different perspective and enrich our research. The recent meeting with Hermès is a case in point. Discussing the management changes at Burberry, we were reminded by Patrick Thomas, Hermès' outgoing CEO, that the company's most successful period was when the Creative Officer was the CEO. Hermès also moved into beauty, now a successful business segment. The management change at Hermès is not a concern for us; we remain impressed by the control the family owners exercise over the growth rate, and their obvious alignment with external shareholders.

Our reputation as committed long-term investors grows and reaches beyond the management teams of our existing investments. Tesla had done their due diligence on Baillie Gifford and the LTGG team just as we had on them. We had been identified as 'good' investors and thus have had access to Elon Musk where others would not. Indeed, the same can be said about Pony Ma at Tencent; the enigmatic founder is inaccessible to most investors.

We, as investment managers, with the support of our Corporate Governance Team, will continue to engage with the management teams of your investments, focusing on the major issues of strategy and motivation, as well as the honourable but detailed compliance with codes and routine.

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Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	3	Companies	3	Companies	1
Resolutions	19	Resolutions	7	Resolutions	1

Company engagement remains a key component of our investment process and some recent examples are detailed earlier in this report

We have completed the UNPRI survey and our 2014 Governance Review will be published soon

Firmwide Company Engagement

Engagement Type	Company
Corporate Governance	Amazon.com
Executive Remuneration	Burberry Group
AGM or EGM Proposals	Apple, eBay

Notes on company engagements highlighted in blue can be found in this report. Notes on other company engagements are available on request.

Company	Engagement Report
Amazon.com	Amazon is a company we all know well and very simplistically there are two aspects to the business; the IT and innovation side, and the logistics aspect - warehouses and distribution. We are currently speaking to the company about the different challenges and corporate risks that each of these generates. Engagement is ongoing.
eBay	We had a conference call with Carl Icahn ahead of the eBay AGM. He had filed a proxy statement with the SEC and was keen to speak to a number of eBay's institutional shareholders. He wants two new independent directors to be elected to the board and to prompt a partial IPO of PayPal. We are discussing the details of the proposals. The meeting is in April 2014 and so our voting decision will appear in the second quarter 2014 Governance Report.

Votes Cast in Favour

Companies	Voting Rationale
Apple, Novozymes, Whole Foods Market	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Apple	AGM 28/02/14	8-11	We opposed four shareholder resolutions as we believe the proposals are overly prescriptive and of minimal benefit to shareholders.
Novozymes	AGM 26/02/14	10, 10b	We opposed two shareholder resolutions as we believe they are overly prescriptive and not in shareholders best interests.
Whole Foods Market	AGM 24/02/14	5	We opposed a shareholder resolution requesting the company use confidential voting tallies as it is too restrictive and not in the best interest of shareholders.
Whole Foods Market	AGM 24/02/14	4	We opposed a shareholder resolution requesting a policy for the recoupment of unearned bonuses as we believe the company's current policy is sufficient.

Votes Abstained

Company	Meeting Details	Resolution(s)	Voting Rationale
Apple	AGM 28/02/14	6	We abstained on the executives' compensation as although the company has amended its policy during the year, we continue to encourage further improvements to enhance alignment with shareholders'.

Votes Withheld

We did not withhold on any resolutions during the period.