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Q&A: Blue Harbour CEO Clifton Robbins talks ESG, WebMD and responsible investing

Robbins also discussed ValueAct's recent investment in KKR and the current undervaluation of public alternative asset managers. *By Miles Kruppa*

Blue Harbour Group markets itself as a so-called "friendly activist" typically avoiding proxy fights and securing board seats in exchange for private advocacy at its portfolio companies. However, the $3.4 billion manager has recently become a loud public advocate for one cause: investing in accordance with environmental, social and governance principles.

The firm, led by former Kohlberg Kravis Roberts & Co. partner Clifton Robbins, recently became a signatory to the United Nations Principles for Responsible Investment and adapted portions of the PRI for its own ESG policy, which it lists on its website. Blue Harbour is now also incorporating ESG principles into its activism and due diligence process of all potential investments.

Blue Harbour's investments are currently concentrated in industrials, technology and medical companies. That includes Rowan Companies, an offshore petroleum drilling contractor (while some ESG investors would entirely avoid investing in oil and gas companies, Blue Harbour says it goes "beyond only negative screening" and considers the ways companies are working toward being more environmentally and socially conscious).

Robbins' increased focus on ESG comes after a redemptory year for his firm: The unhedged Blue Harbour Active Ownership Partners fund gained 15.5% last year after dropping 4.2% in 2015, according to performance figures seen by Absolute Return.

At the 13D Monitor Active-Passive Investor Summit last month, Robbins pitched WebMD, the medical communications company Blue Harbour disclosed it owned 9% of in March. In the presentation, Robbins said he is optimistic about the company's Medscape business, which is oriented toward medical professionals, and is working with management on a potential sale.

Following the presentation, Robbins discussed WebMD, ESG and ValueAct Capital's investment in KKR with *Absolute Return*. The transcript below has been edited for clarity.

AR: I thought your presentation was pretty easy to follow. Very clear.
CR: Good. Do you use WebMD?

AR: I have in the past. I try to keep pretty healthy.
CR: Yeah, me too.

AR: With your ESG push, can you take me through the due diligence you did on WebMD from the first step to the final investment?
CR: When we were doing our regular due diligence on WebMD, which we do on any company, we're usually focused on valuation and the sum-of-the-parts play, the [discounted cash flow] and the quality of the management team, all our normal things. We also put them through our new ESG diagnostic. That means meeting with them in separate meetings and calls just on ESG issues. And we had identified in preparation for that, we thought, what the key ESG issues in this company would be. The primary risk that we were concerned about was on data privacy and data security, because obviously they have 75 million monthly users that come to their site and they know a lot about those people. Are they interested in pancreatic cancer? Are they going to the obesity site? You can understand why data security — data privacy—is a risk and important.

We discussed that with them, and we wanted to get an independent


Clifton Robbins

Photo: 13D Monitor

vetting of their systems, of their training. How do they train their people? How do they test the IT? How do they test for data security? What software do they use? Also, importantly, who does it report to? How important is it? Do people get compensated on it? Does it go all the way up to the board? We got confirmation on all these things. And I have to admit to you, two years ago if we looked at WebMD this would not have been on our list. We would have been cognizant of this issue, but we wouldn't have had separate meetings on this point. We came away on that particular point, and you can always do better, but confident they had really good culture, training, reporting, compensation on that.

AR: So that goes down to the way they treat their workers?

CR: There's that. It really goes to the technology and the ethos around the importance of data security and the privacy.

Another thing that was important was how they treat their people. This is a company where the customers are predominately women. More women go to WebMD than men, just as a fact. And that made us sensitive to the issue. What is the culture there? Is it an issue where they have gender pay equality? Because if they didn't and if that ever got out, that could be a problem for customers. We wanted to really go in on gender pay equality. Do they have women in areas of senior responsibility at the company? Is it a place where you can get promoted easily if you're a woman? What is their attitude on people with disabilities, or minorities generally? We came away very confident, and we saw some anecdotal evidence of this. For example, they make it easy to work on disabilities. The culture is good, and it's not good at every company, so I think it's a company that gets a high grade in that regard.

AR: So it's unique to each company (the due diligence process)?

CR: What's not unique is if a company, if a senior management team or a board, doesn't care about these issues, is not properly assessing the risk in these issues. It opens up to my mind, how do they evaluate risk in their day-to-day business? You still meet CEOs who don't care about gender pay equality, don't know about their environmental disclosures, don't know what underage workers they have working in foreign subsidiaries — people who are in the fog on ESG. The issue there is not just that. It raises in my mind, what kind of risk manager is this? What is he doing with his base business? I think that, turning it around, the types of companies we're investing in that have good ESG profiles: They're going to be more likely to listen to us and the things we want them to do in other spheres. They're going to be wanting to win and wanting to unlock value and be willing to listen to large stockholders, be good people, have integrity. I think there's a good correlation there.

AR: You also mentioned in the presentation there are some governance things you're working on at the company. Can you expand?

CR: During our due diligence, and this is public record, [WebMD] have had some withhold votes on say-on-pay in the past. They know this, of course, so we have had an open dialogue with them, and I'm encouraged that we together will be able to make some progress on improving whatever deficiencies they have in that field.

This is not a big issue. I didn't like it though. Companies shouldn't have withhold votes on say-on-pay. I think the company is sensitive to that, and they certainly know it's important to us. I'm encouraged that it will change. This whole thing where the company may be sold before the next proxy season — if it's not, I think they will do better. Hopefully they will do better.

AR: So overall, WebMD is a pretty good company ESG-wise?

CR: One thing that we really saw as a positive there is: Because they do digital marketing of drugs, that's really good for compliance, because there's a record of what the drug was marketed for and how the drug was described. Most drugs that aren't marketed digitally — it's marketed by a [pharmaceutical] rep in a one-on-one relationship with a doctor, and nobody is listening to that conversation. This is really an issue — that doctors will prescribe drugs for off-label use, maybe not with the right dosage. Even on television, when you listen to these ads with the side effects thing — I don't think it's a very effective way. So I think they're doing a good thing. It's a positive social good, and that is better compliance in this field. It's not why we're invested in the company.

AR: So it's a bonus. But let's say there's a company that's not a positive on ESG – would you consider taking a position in the company and advocating for that behind the scenes?

CR: Great question. So there are three groups of companies. There's a group of companies — their ESG profile is so bad we're never going to invest in them.

AR: Like?

CR: Like predatorial lending, private prisons, or just people who deny the science of climate change. I don't think we ever would have invested with them anyway, but there are going to be companies that we're going to meet along the way — the ESG profile is going to be so negative that we're not going to bet on them.

And then there are going to be a whole swath of companies like WebMD where there's some ESG issues, like the [say-on-pay] issue — immaterial, we're cognizant of them, and they're going to be fine.

And then there's a bunch of companies on the other side where there are material ESG issues, but we're investing in them because we're confident that we can change the company. We own 5% to 10% of the company, and we're confident that even though this ESG risk is there, we've properly evaluated it and priced it into our risk matrix. We're going to take on the responsibility that we can make change.

AR: A lot of times when people say ESG investing they make it seem like it limits investment options. Would you say that is not the case?

CR: I don't think that's the case at all. If we were the type of firm that would have invested in anything, maybe that would have been the case. We've been a responsible investor for 12 years. I never was going to invest in private prisons or predatorial lending ever. So I don't think this is reducing our opportunity set. I think it's going to improve our returns because we run so concentrated. If we can reduce risk — anything I can do to reduce risk and avoid a bad company is hugely important to me. And I also think it will improve some outcomes, so I'm excited about it. I think it's going to be a new paradigm for smart investing.

AR: I know you evaluate companies one-by-one – you're a value investor – but are there any big structural changes you see going on that make certain companies more undervalued?

CR: Sure. So not with ESG, but more generally speaking, I do believe [in] the bi-partisan support we are going to get for repatriation. Notwithstanding what some say, I don't think that money is going into [property, construction of plants and equipment] and jobs, because most companies had ample access to credit over the last two or three years, and if you wanted to build a plant, you could get the money to do it. I think much of that money is going to go into buybacks and [mergers and acquisitions], so I do think that, structurally, that is going to continue this tailwind pattern in the M&A environment.

Second — and I know I'm speaking to my own book here — I really like the positioning in this mid-cap space. Because our companies are largely domestic-focused — they're not focused on trade wars, value-added tax and foreign exchange issues — I'm generalizing, but I think most smaller companies are going to be better beneficiaries from infrastructure spending, this M&A trend we discussed and lower corporate tax rates. Structurally, it's hard to read what's going to happen in Washington. Nobody knows for sure, but I think if Trump gets part of his tax agenda and repatriation, that's going to be good for both smaller companies and for M&A.

Healthcare is another industry we're focused on. Before the election the healthcare sector had come under a lot of stress because there are these concerns about what Hillary would do and now what Trump is going to do, whether the [Affordable Care Act] is going to be repealed or replaced. The whole sector is in turmoil, and that's good, because there's always jewels in there. WebMD is a good example of a company that's really not affected by the ACA reform in a material way. When there's turmoil in the industry, there's always opportunity.

AR: I wanted to ask you about KKR.

CR: Yeah, what about KKR?

AR: Well, did you see the presentation in there?

CR: KKR is great. I was a partner there for a long time, but I left 17 years ago. So I'm not current, really. What can I tell you about KKR?

AR: What do you think about the information in the presentation?

CR: I didn't see the presentation, but I am aware of it. Again, I'm not involved in KKR and have not been for 17 years, but observing KKR, it's a great franchise. Like Blackstone and Oaktree — and KKR — all these asset managers appear to be undervalued. The market is valuing them with very little credit to the optionality of the carried interest they have. And KKR is just a great company, so I'm not surprised that somebody like ValueAct sees that inherent value.

AR: And you invest kind of similarly to ValueAct, so…

CR: Yeah. They're larger cap, we're small-cap, but we invest similarly. I have a high regard for ValueAct and a high regard for KKR, so I'm not at all surprised. As an observer, I would view these public alternative asset managers as being undervalued.

AR: Is that because of structural changes, like the passive/active…

CR: I think, I'm just guessing, but I think that they're complicated, hard to value, and I think most investors capitalize the value of the management fee, but it's hard for them to value the potential carry. Of course, there's tremendous upside in the carry of these types of vehicles. There might be other structural reasons why they're undervalued. But they are [undervalued] — not just KKR, but generally. ValueAct is very clever, so I'm not surprised that they have some variant view to the market on that.