

CORPORATE EXCELLENCE INSIGHTS

Hérens Quality AM is a specialized provider of systematic Quality Investment Solutions and one of the few providers of Quality equity investment strategies worldwide. Corporate Excellence Insight is our monthly publication that includes a brief update on markets and our thoughts about major trends that are impacting the investment management industry.

MARKET UPDATE: VALUE STOCKS CONTINUE THEIR RECOVERY

Stock market advanced to new all-time high in October, despite indications that the U.S. manufacturing sector was still contracting, although at a slower pace than in the previous month. Value stocks continued their recovery path, led by financial stocks' strong comeback.

\$60bn

TREASURY MONTHLY PURCHASES

Fed re-started balance sheet expansion with \$60 bn monthly purchases effectively starting QE4 (while at the same time not calling it QE)

8325.99

NASDAQ ALL-TIME HIGH

Strong results from Microsoft, Apple and Facebook pushed technology stock index to all-time high in October

18%

EQUITY HEDGE FUND EXPOSURE

Hedge fund exposure towards equity markets is at 20 year low according to Hedge Fund Research. That could spark year-end rally as some of this money on the sidelines could hit the market

MONTHLY TOPIC: ALT-DATA IN ACTION

For the last few centuries economists developed plenty of concepts for assessing quality of business models, mostly based on numbers you could typically find in quarterly filings, company presentations and annual reports. However, it might not be enough in striving to generate return alpha. One should also be looking at the alternative datasets that many other analysts are still neglecting. One of the informational puzzle pieces about the company that could give valuable insights into how employees assess management, internal culture or outlook is Glassdoor reviews.

Combined Glassdoor rating has strong performance significance in top quintile – best companies deliver much better returns, especially on the 2 year horizon. For the bottom quintile, 10 worst firms had extremely negative performance. Other companies from bottom quintile with higher rating generated returns weaker than the median, but the effect is not that profound.

Glassdoor data is valuable if one wants to add soft and dynamic factors coming from company insiders to enhance stock selection approach. Ratings are positively skewed towards technology sector and negatively to labor intensive businesses like retailers and manufacturing.

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ALT-DATA IN ACTION: USING GLASSDOOR REVIEWS IN ASSESSING QUALITY OF COMPANIES

Something old, something new

For the last few centuries economists developed plenty of concepts for assessing quality of business models, mostly based on numbers you could typically find in quarterly filings, company presentations and annual reports. However, it might not be enough in striving to generate return alpha. As Gordon Gekko put it in 'Wall Street' movie – "information is the most valuable commodity" in this data-driven world, which means that one should also be looking at the alternative datasets that many other analysts are still neglecting. One of these sources of precious information about the company that could give valuable insights into how employees assess management, internal culture or outlook is Glassdoor reviews.

Methodology

We started tracking Glassdoor data in October 2017 and as two full years have passed, we can already make first conclusions. There are several metrics that reviews website is providing, but we concentrated on four of them – Company Overall Rating, CEO Approval, Business Outlook and Corporate Culture – as these have the highest significance when assessing the quality of the corporation. All metrics were normalized to the scale from 0% to 100% and average of those values was used as a combined rating. Universe was S&P 500, but we excluded companies that have less than 100 company reviews. Also, if a company had less than 50 CEO reviews then this value was not taken into account for combined rating calculation. We also excluded the companies that were acquired during these 2 years as this is a random factor that has no influence on the quality of results – equal amount of companies were acquired from top and bottom quintiles.

Results are surprisingly straight-forward and consistent

Combined Glassdoor rating has strong performance significance in top quintile – best companies deliver much better returns, especially on the 2 year horizon. For the bottom quintile, 10 worst firms had extremely negative performance. Other companies from bottom quintile with higher rating generated returns weaker than the median, but the effect is not that profound.

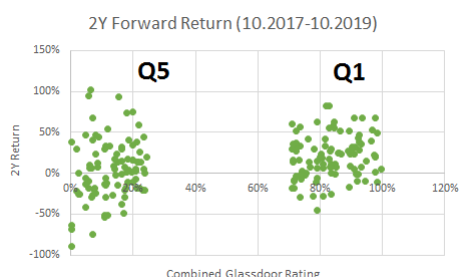
Fig. 1: Company stock performance based on Glassdoor Rating

	1Y Forward Return	2Y Forward Return
Top 10	11%	27%
Top 20	10%	27%
Top 30	4%	26%
Top 50	3%	24%
Top 100	2%	20%
S&P 500 Average	1%	12%
Bottom 100	0%	4%
Bottom 50	-5%	-2%
Bottom 30	-3%	-2%
Bottom 20	-4%	-4%
Bottom 10	-11%	-24%

Source: Hérens Quality Asset Management, Reuters

Probably the chart below provides a better explanation. Huge dispersion in 5th quintile (Q5) – many negative, but also positive returns (Advanced Auto Parts +100%, Dollar General +95%), but in 1st quintile (Q1) majority of stocks' (60%) returns have beaten the S&P 500 average return and their standard deviation is much lower.

Fig. 2: Top and bottom quintile stock performance based on Glassdoor Rating



Who would rank the best in 2019

From the abovementioned, the key finding is that application of Glassdoor combined rating as an overlay can significantly enhance portfolio return. Let's look at the top 25 companies that rank best as of October 2019 and are worth considering as addition to your watch list. Apart of very obvious cases, like software giants Facebook (#1 two years ago), Microsoft and Alphabet that have way above average compensation packages, there are also REITs, healthcare, consumer finance, machinery and even an airline industry representatives.

Fig. 3: Best S&P 500 rated companies on Glassdoor as of October 2019

Company	Industry Group	Reviews	Rating	CEO Rating	Outlook	Culture	Combined Rating
Alexion Pharmaceuticals Inc	Biotechnology	371	4.5	NER	87	4.5	99%
Capital One Financial Corp	Consumer Finance	7300	4.3	99	88	4.5	99%
Intuitive Surgical Inc	Health Care Equipment & Supplies	425	4.5	97	88	4.4	99%
Salesforce.com Inc	Software	5500	4.3	97	84	4.5	98%
NVIDIA Corp	Semiconductors & Semiconductor Equipment	2400	4.4	98	84	4.3	98%
Robert Half International Inc	Professional Services	6800	4.4	NER	80	4.4	98%
Facebook Inc	Internet Software & Services	3900	4.4	99	76	4.4	97%
Digital Realty Trust Inc	Equity Real Estate Investment Trusts (REITs)	253	4.4	96	90	4.2	97%
AvalonBay Communities Inc	Equity Real Estate Investment Trusts (REITs)	563	4.3	94	81	4.4	96%
Adobe Systems Inc	Software	4000	4.2	96	82	4.2	96%
Equity Residential	Equity Real Estate Investment Trusts (REITs)	584	4.2	NER	76	4.4	96%
Microsoft Corp	Software	23000	4.2	97	82	4.1	96%
Illumina Inc	Life Sciences Tools & Services	907	4.2	96	81	4.2	96%
Clorox Co	Household Products	864	4.2	95	76	4.2	95%
Alphabet Inc	Internet Software & Services	12000	4.4	92	78	4.3	94%
Brown-Forman Corp	Beverages	332	4.3	NER	72	4.4	94%
PVH Corp	Textiles, Apparel & Luxury Goods	911	4.2	94	75	4.2	94%
Southwest Airlines Co	Airlines	2000	4.3	91	82	4.4	94%
Intuit Inc	Software	4700	4.2	91	83	4.4	94%
ANSYS Inc	Software	341	4.1	98	90	3.9	94%
Extra Space Storage Inc	Equity Real Estate Investment Trusts (REITs)	1000	4.2	91	80	4.3	93%
Hilton Worldwide Holdings Inc	Hotels, Restaurants & Leisure	4500	4.1	95	74	4.1	93%
Deere & Co	Machinery	2300	4.1	96	71	4.2	92%
Boston Scientific Corp	Health Care Equipment & Supplies	1700	4	97	79	4	92%
Nucor Corp	Metals & Mining	219	4	92	79	4.2	91%
Garmin Ltd	Household Durables	753	4	95	79	4	91%
Mastercard Inc	IT Services	1900	4	95	77	3.9	90%
HP Inc	Technology Hardware, Storage & Peripherals	3100	4	94	69	4.2	90%
Agilent Technologies Inc	Life Sciences Tools & Services	1300	4	92	74	4.1	90%
Delta Air Lines Inc	Airlines	2700	4.1	89	79	4.1	89%

Source: Hérens Quality Asset Management, Glassdoor; NER - not enough reviews

There is a strong correlation between labor intensity of the business and its combined Glassdoor rating - most represented sectors in Q1 (best) are technology (24%), financials (15%) and healthcare (14%), while in Q5 (worst) – Consumer Discretionary (24%) and Industrials (14%) are having the highest weight.

What about Quality?

Quality companies by definition should have higher scores also in this framework and it is well confirmed with 72% average combined rating for our US portfolio, which would fall in first quintile. But, apart from highly ranked FAMGA (Facebook, Apple, Microsoft, Google, Amazon) ecosystem firms, there are also poorly ranked logistics player Expeditors, electronic equipment manufacturer TE Connectivity and biggest US health insurer United Health.

Fig. 4: Best and worst rated companies on Glassdoor in HQAM US Portfolio

Company	Industry Group	Reviews	Rating	CEO Rating	Outlook	Culture	Combined Rating
Facebook Inc	Internet Software & Services	3900	4.4	99	76	4.4	97%
Microsoft Corp	Software	23000	4.2	97	82	4.1	96%
Alphabet Inc	Internet Software & Services	12000	4.4	92	78	4.3	94%
Mastercard Inc	IT Services	1900	4	95	77	3.9	90%
Agilent Technologies Inc	Life Sciences Tools & Services	1300	4	92	74	4.1	90%
Hormel Foods Corp	Food Products	292	3.6	80	66	3.4	52%
Electronic Arts Inc	Software	2200	3.7	80	49	3.7	52%
UnitedHealth Group Inc	Health Care Providers & Services	11000	3.4	78	54	3.4	38%
TE Connectivity Ltd	Electronic Equipment, Instruments & Compon	1400	3.5	80	47	3.4	37%
Expeditors International of Wash Air Freight & Logistics		1100	3.1	74	49	3.1	22%

Source: Hérens Quality Asset Management, Glassdoor

Conclusion

Glassdoor data is certainly valuable if one wants to add some soft and dynamic factors that come from company insiders to stock selection approach - it could significantly increase portfolio's alpha and reduce volatility. Ratings are positively skewed towards technology sector and negatively to labor intensive businesses like retailers and manufacturing, so one possible strategy here would be choosing best-in-class company if one wants to avoid industry biases. Another important trend is that companies with low Glassdoor ratings might engage in their rating manipulation by feeding fake reviews and, therefore, misleading prospective employees and investors. But these tactics could be well spotted by analyst, who is diligent enough.