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Investor Relations Roundtable

2008 NATIONAL DIRECTORS INSTITUTE

INVESTOR RELATIONS ROUNDTABLE

INTRODUCTION

Foley presented the "Investor Relations Roundtable" as part of the seventh annual National Directors Institute, hosted by Foley & Lardner LLP on March 6, 2008, in Chicago. The roundtable discussion was facilitated by Richard Grubaugh of D.F. King & Co., Inc.; Linda Kelso, Chair of Foley's Securities Practice; Christine Marx of The St. Joe Company; Gordon McCoun of FD/Ashton Partners; Mary Ryan of Aftermarket Technology Corporation; Brendan Sheehan of Corporate Secretary magazine; and Anna Snider of IR Magazine.

Investor relations (IR) professionals are tasked with effectively managing communication with shareholders and analysts to maximize a company's relationship with both parties. This requires proactive preparation and training rather than reactive crisis management. It also means tailoring communications to meet the wide variety of investment goals among shareholder constituents, and balancing regulatory concerns with shareholder demands for information, including earnings guidance.

PROACTIVE PREPARATION

Effective direction of communication requires proactive preparation and the defined assignment of communication responsibility. Everyone, from directors to officers to mid-level management to staff, needs to know how to appropriately direct information requests. In addition, those tasked with investor communication need proper training to effectively present information. In advance of such a presentation, IR may prepare a script for management in order to prevent disclosure of nonpublic information. Another best practice is to conduct a study group prior to the release of information, in which participants review the information to be reported and anticipate and prepare for questions that are likely to be asked. IR must be able to anticipate every question and prepare each response for management.

Preparation also includes the development of the communication skills of mid-level executives, to hone the skills they will need as their careers progress. Communicators also should be educated regarding proper terminology so that they may avoid the inadvertent use of language with a specific technical meaning to the market, which meaning may not intended by the communicator. Companies may also consider engaging a consultant who can provide an outside perspective to assist with such preparation and training. The key is to have an IR plan in place and not to create one solely as part of crisis management.

VARIED SHAREHOLDER INFORMATION NEEDS

IR professionals recognize that shareholder constituents have widely varied investment goals and, therefore, widely varied information needs. An actively managed hedge fund is likely to demand more information than a "traditional" institutional investor will. Ideally, a company should tailor communications to meet the needs of various shareholder groups. Long-term investors are not likely to have the same agenda as are investors looking to churn up short-term profits. However, the risk is that short-term investors with an activist agenda might use corporate governance issues to bring long-term investors to that agenda.

Due in large part to the lack of transparency in shareholder identity, it may not always be possible for a company to accurately identify its shareholder constituents. The transparency issue is compounded by the practice of short-selling, making it nearly impossible to know exactly who has voting rights at any particular point in time. Unfortunately, there is no cost-effective way for a company to stay informed about what is truly happening in its market. Quarterly Form 13F filings are somewhat stale by the time they are filed. Companies can obtain DTC lists on a daily basis, but these are listed by custodian — which may show trends but not identity. Companies also can get lists of nonobjecting beneficial owners, but that can be quite costly and still may not provide full transparency. There are also surveillance firms that companies can engage to monitor daily activity, but such services can be cost prohibitive. In the end, it may not be possible for IR to identify all shareholder constituents, but it is still necessary to try to understand them.

EARNINGS GUIDANCE

To give or not to give — that is the question. There appears to be a definite trend in moving away from quarterly guidance, due to the difficulty of making accurate projections in light of cyclicality and short-term market trends. The decision as to whether to provide just annual earnings guidance (increasingly done within ranges) or no earnings guidance at all varies by industry and by the ability of the company to make accurate forecasts based on industry conditions. For example, it may be nearly impossible for a real estate company to provide accurate forecasts in a down market. For companies making the decision to stop providing or to limit earnings guidance, it is important to prepare the market for the change and to build support from shareholders and analysts. Moving away from earnings guidance ideally should be counterbalanced with an increase in "soft guidance," such as increased disclosure in management's discussion and analysis (MD &A) in 1934 Act reports. For example, a pre-earnings biotech company could provide information about its milestones. In general, MD&A should describe revenue and other drivers to provide sufficient information for the market to digest. From a legal-risk standpoint, providing such soft guidance rather than earnings predictions may be prudent. There are certainly more class actions against companies that issue earnings guidance and miss than against companies that do not release it at all.

Since 1995, companies have provided earnings guidance in reliance on the safe harbor provisions of Section 21E of the 1934 Act. Under Section 21E, the availability of the safe harbor can be determined in connection with a motion to dismiss, ideally limiting the substantial time and expense relating to discovery. However, a 2004 decision by the U.S. Court of Appeals for the Seventh Circuit, Asher v. Baxter International Incorporated, left uncertainty regarding the scope of protection provided by the safe harbor. Despite concerns regarding earnings guidance, there are still proponents who believe that it is better to have control over predictions than to “subcontract forecasting” to third parties with less information. In addition, in some industries, earnings guidance is an absolute must in order to have analyst coverage. For companies that determine that earnings guidance cannot be avoided, IR and compliance must work together to ensure that the appropriate safe harbor legends (which should be reviewed and updated periodically) are used with all forward-looking statements, including in oral presentations and Web disclosures.

SHAREHOLDER ACCESS TO DIRECTORS

Anecdotal evidence indicates an increased desire by investors to communicate directly with directors. This trend is likely due to the new environment of hedge funds looking for an edge by seeking a level of information that institutional investors simply did not request in the past. Such requests can create challenges for IR professionals, who essentially must act as gatekeepers to determine whether facilitating access is in the best interest of the company. Engaging the investor and providing access to directors may be the best course of action, but at a certain point such demands can become a distraction; the IR officer, therefore, must determine who deserves an audience. Some companies require that every information request, whether it comes through the company’s Web site, the general switchboard, or a direct call to a director or officer, be redirected through the IR professional, who joins every call and every meeting in order to be fully apprised of the information that is being provided to investors and analysts. The worst-case scenario for an IR professional is the activist shareholder who makes an unsolicited call to a director at home. The board of directors should be instructed to refer such calls back to IR. Some companies (Pfizer and The Home Depot are recent examples) have taken the approach of proactively providing shareholders with an open dialogue with the board, but this is certainly the exception rather than the rule. The prevailing sentiment is that, absent unique circumstances, the board should not be directly involved with shareholders.

BENEFITS OF OPEN COMMUNICATION

Some companies could elect to face investor relations challenges by using Regulation FD as a shield to limit information disclosure. However, IR professionals are in agreement that open communication (even if such communication is about limiting information or guidance) is necessary to develop positive relationships with investors and analysts. In an information vacuum, investors will continue to make investment decisions, but such decisions are likely to be based on inference rather than fact.

FOR MORE INFORMATION

For more information on this session or the seventh annual National Directors Institute, visit Foley.com/ndi or contact the moderators and panelists directly.

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