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Investor and Shareholder Relations in the Current Economic Climate

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On February 18, 2009, Foley & Lardner LLP presented "Investor and Shareholder Relations in the Current Economic Climate" as part of its National Directors Institute — 2009 Web Conference Series. John K. Wilson, Foley Transactional & Securities Partner, moderated the panel, which included Jeffrey Brown, Senior Corporate Counsel, Motorola, Inc.; Richard H. Grubaugh, Senior Vice President, D.F. King & Co., Inc.; Gordon McCoun, Vice Chairman and Director of Investor Relations, Financial Dynamics; and John Palmer, Co-Founder, PL Capital LLC. The panel presented a balanced discussion of how the current economic crisis has impacted the interaction between a public company and shareholders. The panel also addressed developing a strategy to prepare for and respond to contact from an activist investor as well as the activist investor's expectations of the company's management and board of directors.

Impact of the Financial Crisis on Investor Relations

Providing Guidance on Future Performance

Although the financial crisis has made estimating future company performance difficult, management should stop providing guidance only as a last resort. Investors use company-provided guidance in preparing financial models to determine value and compare companies within the same industry. When management discontinues providing guidance on future performance, it is much more difficult for an investor to evaluate that company and, as a result, determine winners within an industry. However, given the financial crisis, the investment community has provided management with more latitude in terms of the type of information expected. Although no one solution will work for every company, companies should attempt to maintain at least some level of guidance, share the assumptions underlying such guidance with the financial community, and attempt to differentiate between the cyclical and secular factors impacting the company.

Investor Relations

During the past year, there appears to have been a shift in the tenor and quality of discussions that hedge funds and other activist investors are having with companies. Many companies are increasingly starting to view these investors as business partners and are more likely to consider advice from these investors on major strategic decisions, including whether to sell the business and whether the company has the right management. This is a shift from prior years, when such investors were viewed more as adversaries with a short-term agenda. The shift may be due in part to the fact that such investors are able to generate value in ways other than just forcing the sale of a company. Given the significant recent stock-price declines, these investors also can generate value through stock-price increases resulting from improved company performance. Additionally, boards of directors appear more actively involved in discussions with investors, lenders, and work-out professionals. The amount of information provided by companies to such investors also appears to have increased as concerns about the U.S. Securities and Exchange Commission's (SEC's) Regulation Fair Disclosure (Regulation FD) appear to have waned relative to prior years.

A Preview of the Upcoming Proxy Season

Due to poor economic and stock-price performance during the past year, 2009 is expected to be a very challenging and busy year for management at annual meetings. Given recent poor performance and negative headlines, the retail investor, who in prior periods would either refrain from voting or generally follow management's recommendations, is now engaged and more skeptical of management. Compensation issues are likely going to be a primary driver this year, and an unprecedented number of hold or against recommendations on proxy matters from advisory firms are expected. Many companies will need to obtain shareholder approval to re-price or exchange stock options because declines in share prices have provided companies with limited executive compensation flexibility. Currently more than 50 percent of the S&P 500 companies have majority voting or policies regarding director resignation, and it is likely that some directors will not get elected or be under pressure to resign due to general shareholder dissatisfaction over company performance and executive compensation concerns.

Preparing for Communication With Shareholders

Procedural Preparation

Preparing for contact from shareholders can help a company more effectively deal with an activist shareholder. As a preliminary matter, a company should have in place a shareholder response team comprising both external and internal representatives. The team also should include the company's key officers, including the chief executive officer, chief financial officer, general counsel, investor relations personnel, and board of directors, along with the company's outside counsel, investment bank, proxy soliciting firm, and financial public relations firm. The team also should have a clearly defined point person and a well-known communication policy so that everyone within the company knows who to contact in the event that a shareholder contacts him or her. When communications from shareholders are received, the point person can determine whether contact with higher-level management is appropriate based on the shareholder's size, the length of time the shareholder has held shares in the company, and the substance of the shareholder's concerns.

In determining when the board of directors should be apprised of shareholder contacts, the management needs to determine the nature of the activist investor. If the team determines the potential threat from the shareholder is real, the board of directors should be notified. In such situations, the company should meet with the activist investor, since ignoring the investor likely will not resolve the issue that prompted the investor to contact the company. Generally, the initial meeting should be with the company's investor relations person or chief financial officer. Future meetings, if necessary, typically include senior management, but it can be helpful to have a board member participate to provide a different perspective to the discussions.

Anticipating Shareholder Concerns

A company that is able to anticipate the specific concerns and expectations of shareholders by truly understanding its profile is more likely to successfully minimize any negative impact on the company that may result from interaction with shareholders. The company and board of directors should perform in-depth self analyses to understand factors that may make the company an attractive takeover candidate or the target of a proxy contest. Typical factors include whether a company has value that is easily transferable, such as excessive cash, or whether there has been recent poor performance. A company's investment banking firm can be of assistance to the board of directors as it considers whether the company is structured or in a position to be a likely takeover candidate or the target of a proxy contest.

In addition to reviewing the company's structure and performance factors, the board of directors should conduct an annual review of its takeover defenses. Outside counsel also should participate in this review to provide updates on current best practices and any changes due to judicial rulings or legislative actions.

Ensuring a Consistent Dialogue

Another important aspect to dealing with shareholders is ensuring that there is a consistent and frequent dialogue with shareholders about the company's strategy, challenges, and performance. The efforts to maintain such a dialogue will pay dividends should any conflict with an activist shareholder arise in the future. Once a company receives an inquiry from an activist shareholder, the company will have limited time to explain its strategy with other shareholders. As such, management will want existing shareholders on its side, and it is much easier to accomplish that if management has been actively updating and explaining its strategy to increase and realize shareholder value. Additionally, maintaining open lines of communication with hedge funds and activist shareholders while simultaneously retaining an appropriate level of control over the direction of the company may increase a company's likelihood of being successful in dealing with such shareholders.

Identifying Hedge Funds and Activist Shareholders

In order to anticipate potential conflicts with activist shareholders, management and the board of directors should be continuously apprised of the makeup of the company's shareholder base. Companies also should attempt, where possible, to identify relationships or cooperative interaction among shareholders and should monitor unusual trading activity to identify activist shareholders who may be positioning themselves to initiate a dialogue with the company. Some of this information can be obtained through the use of a stock-watch service or through a company's regular review of shareholder filings with the SEC on Schedule 13F or Schedule 13D.

Knowing the shareholder base, especially significant holders, also is necessary for the company's management to ensure it maintains consistent and open lines of communication with such holders.

Changing Sentiment in Response to the Financial Crisis

The relationship between companies and shareholders has changed dramatically as company performance and stock prices have fallen in response to the financial crisis. Both institutional and retail investors are frustrated with management. The poor performance also has prompted a substantially increased interest from retail investors at annual meetings, where they have become much more active by asking pointed and engaging questions. This is dramatically different than previous annual meetings where retail investors infrequently attended and rarely questioned the company.

The changed financial landscape also has resulted in certain hedge funds running more proxy contests than in prior years. Additionally, for certain funds, the focus of such proxy contests has changed from running for actual board seats to waging proxy contests on such matters as staggered boards, executive compensation, and majority voting.

For More Information
For more information on this session or Foley's National Directors Institute — 2009 Web Conference Series, visit Foley.com/ndi or contact the moderators and panelists directly.

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