



“Investor Relations: It’s Not a Dog and Pony Show”

**Louis M. Thompson, Jr.
President & CEO
National Investor Relations Institute**

May 4, 2006

California Bankers Association

1





Background on Forward-Looking Information

- In the early days of securities regulation, the SEC forbade companies to provide forward-looking information such as earnings forecasts
- Late 70s, the SEC did a u-turn
- Decade later, companies increasingly confronted with strike suits over missed EPS forecasts
- 1993 – Niri, as part of a broad business coalition-- pressed Congress for tort reform related to these kinds of shareholder law suits
- 1995 - Congress passed the Private Securities Litigation Reform Act



Prelude to Regulation Fair Disclosure

- 1995 - NIRI survey of corporate disclosure practices revealed that two-thirds of respondents engaged in varying degrees of selective disclosure
- Formed NIRI/CFA Institute task force on corporate disclosure
- 1996 – NIRI published first Standards of Practice for Corporate Disclosure
- 1998 – SEC Chairman Arthur Levitt called on companies to stop “the game of winks and nods” and level the playing field for all investors

Regulation FD

- 1999 – SEC began working on Reg FD
- ABA, SIA, CFAL and others opposed the rule-making citing dire predictions if it were to pass
- NIRI worked with SEC staff to craft a rule that companies could live with
- October 23, 2000 – SEC passed Reg FD

May 4, 2006

California Bankers Association



Initial Response

- Analysts complained that companies were shutting down disclosure
- Institutional investors said “quality of information fell off the charts”
- Corporate counsel urged CEOs to stop one-on-one meetings with sell-side analysts; most did not stop
- Today, 97% of companies meet with analysts and portfolio managers in one-on-one sessions



What Reg FD Did

- Defined selective disclosure as “providing material non-public information on a selective basis”
- Used U.S. Supreme Court definition of materiality (TSC Industries v. Northway and Basic v. Levinson) with reference to Staff Accounting Bulletin 99
- Required companies to broadly disseminate material non-public information through means such as:
 - News releases
 - Fully accessible conference calls (webcast or telephonically)
 - Form 8-K filings



What Reg FD Did *(cont.)*

- Defined who was covered under Reg FD (officers, directors, IR and PR people)
- Defined intentional and unintentional disclosure
 - Intentional disclosure – no remedy
 - Unintentional disclosure – 24 hours to rectify through news release, 8-K filing or both
- Cited earnings guidance as the most vulnerable area for violation
- Placed liability on companies for selective disclosure – not analysts or investors for using selectively disclosed information (U.S. Supreme Court – SEC v. Dirks)

What Reg FD Did Not Do

- Increased volatility in stock price movement
- Cause greater dispersion in EPS estimates
- The opposite happened – analysts clustered around company EPS guidance causing the “penny miss” phenomenon and temptation to manage earnings
- Cause companies to stop providing EPS guidance – other factors are influencing that decision
- Decreased the quality of information (2002 study by Bailer, Li, Mao, Zhong)

May 4, 2006

California Bankers Association



Lessons Learned from Reg FD Cases

- Raytheon (2002) – CFO allegedly provided selective guidance to individual analysts after conducting annual analyst meeting
 - Ensure broad public disclosure of any guidance
- Secure Computing (2002) – CEO allegedly unintentionally disclosed significant contract information to portfolio manager. Before issuing news release to remedy the situation, he intentionally disclosed contract information to second portfolio manager
 - Promptly issue public announcement following unintentional disclosure



Lessons Learned from Reg FD Cases *(cont.)*

- **Siebel Systems (2002) – CEO disclosed positive outlook at invitation-only conference in contrast to prior publicly-announced negative outlook**
 - **Insist conference presentations be webcast for broad public dissemination**
- **Motorola (2003) Investigated only in individual phone calls to analysts, CEO clarified public statement by defining significant decline to mean 25% or more**
 - **Because CEO consulted counsel in good faith before making the calls, SEC dropped case**



Lessons Learned from Reg FD Cases (cont.)

- **Schering-Plough (2003) – CEO met with Fidelity, Putnam, Massachusetts Finance and Wellington Management over two-day period saying that third quarter results would be lower because of declining Clariton sales. Private disclosures differed from more optimistic previous public disclosures**
 - **Fidelity and Putnam each sold more than 10 million shares causing share price to decline 17% and trading volume to increase more than 35%**
 - **Made similar statements two weeks later at meeting with analysts and investors at company headquarters after which the company finally issued a news release**

Lessons Learned from Reg FD Cases (cont.)

- CEO fined \$50,000; company fined \$1 million
- Did not cooperate with SEC investigation
- Lessons: (1) avoid private comments on earnings estimates that differ with published estimates (2) make simultaneous public disclosure





Lessons Learned from Reg FD Cases *(cont.)*

- **Siebel Systems (second case 2004) – CFO in private meetings made positive statements about business activity levels that differed from public negative outlooks**
 - **CFO and IR SVP charged with aiding and abetting since company was under cease and desist order from previous case**
 - **IR SVP charged with failure to maintain proper controls to prevent senior management from violating Reg FD**



Lessons Learned from Reg FD Cases *(cont.)*

- **Siebel took SEC to court. Judge Daniels (Southern District of NY) dismissed all six causes of action against Siebel Systems in August 31, 2005. Did not rule on arguments raised by Siebel saying Reg FD was unconstitutional under First Amendment**
- **Daniels said SEC parsed words used by Siebel to demonstrate what was said privately differed from public statements, placing an unreasonable burden on company spokespersons to become linguistic experts or live in fear of violating Reg FD should SEC noting the slightest variance between private and public statements**



Lessons Learned from Reg FD Cases *(cont.)*

- **Flowserve (2005) – CEO and VP, IR met with analysts in private meeting 42 days before the end of the quarter and the 2002 fiscal year and reaffirmed guidance issued publicly a month earlier. Company issued annualized guidance in January 2002 and publicly revised that guidance downward in July, in September and again in October for a total of 30%.**
 - **One analyst issued report interpreting that reaffirmation meant no more downward revisions. Caused share price to increase two days later 6% and trading volume up 75%**
 - **Recognizing this, Flowserve issued 8-K filing noting the reaffirmation**



Lessons Learned from Reg FD Cases *(cont.)*

- SEC charged CEO with intentional disclosure (reckless in not knowing reaffirmation was new material information) and IRO for failing to stop CEO from responding to the analyst's question triggering reaffirmation
- Case caused many companies to revisit their disclosure policies and not reaffirm public guidance in private meetings or not do it more than a week beyond making public statement



Major Takeaways

- Have written disclosure policy
- Train spokespersons to avoid selective disclosure
- Pre-brief CEO or other spokesperson regarding material information, which is public record and which is not
- Have IRO or counsel in with CEO or CFO in private meetings to ride herd



Major Takeaways *(cont.)*

- **Limit number of authorized spokespersons**
- **Observe “quiet period” once company has a handle on earnings**
- **Promptly issue news release if unintentional disclosure is made**
- **If company plans to disclose new material information in private meeting, webcast or simultaneously release the information in news release**

What's Important to Investors?

- Most important factors investors consider in investment decisions:
 - Management credibility – 83%
 - Effective business strategy – 77%
 - Reliable cash flow – 72%
 - Attractive growth in EPS – 68%
 - Strong balance sheet – 61%

(2005 Rivel Research Buy-side study)

Measuring Quality of Management and Credibility

- **Measuring management credibility**
 - Meets or exceeds articulated goals – 68%
 - Honest, forthright and open – 43%
- **Measuring “quality of management”**
 - Needs be visible and meet one-on-one with investors
 - 42% say must meet with management one-on-one prior to purchasing a stock
 - Show progress against goals
 - Build credibility



IR Messages/Strategies should Address Investor Needs

- A clear view of the business and the future from the CEO's perspective including corporate vision, positioning, goals and strategies (an area that investors frequently find lacking in company presentations)
- Discuss intangibles: governance, innovation, customer relations
- Demonstrate quality of management
- Acquisition policy and criteria
- Deal with current and ongoing challenges

Strategic IR Supports Corporate Goals

- Corporate goals include:
 - Achieving fair market value
 - Consistent access to capital at lowest price
 - Achieving/maintaining stakeholder loyalty
- IR supports the achievement of these goals by:
 - Communicating the company's value-creation strategies and metrics to measure progress
 - Setting and maintaining realistic expectations
 - Explaining interim performance in the context of long-term goals and the current environment
 - Fulfilling disclosure obligations
 - Enhancing corporate reputation and brand



NIRI Supports Development of a More Complete Valuation Model

- **Valuation must incorporate non-financial factors in addition to financial assets and performance**
- **NIRI was first strategic partner with the Enhanced Business Reporting Consortium**
- **June 2005 – NIRI and CFA Institute co-sponsored a symposium at Baruch College in New York on “The Future of Corporate Reporting,” focusing on the role of non-financial factors in valuation**



NIRI and CFA Institute Define Analyst/Investor Access to Management

- **“Blackballing” analysts is a bad practice**
- **NIRI and the CFA Institute issued in January 2005 “Best Practice Guidelines Governing Analyst/Corporate Issuer Relations”**
- **NYSE and NASDAQ have sent letters to listed companies urging them to adopt these guidelines and avoid analyst retaliation**



Guidance is Still THE Issue

- No one-size fits all policy
- 66% in NIRI 2006 survey provide EPS guidance
 - Declined 5% from March 2005 survey
 - Substantial increase in companies providing only annualized guidance
 - Substantial decrease in those providing only quarterly guidance



Guidance is Still THE Issue *(cont.)*

- Of the 66% who provide EPS guidance
 - 83% provide a range of EPS estimates
 - 5% provide a point EPS estimate
 - 83% update guidance when there's a material change
- Those not providing EPS guidance are still providing qualitative guidance such as industry trends, key value drivers and expectations for those drivers