IROs' Wish LIST FOR Analysts

Is there such a commodity as the perfect analyst?

Probably not.

But here are **10 ways** analysts can improve their relationship with IROs.

By Bob Burton and Jeff Tryka, CFA

Whether an IRO leads a multiperson staff in a large-cap issuer with dozens of analyst followers or is a small-cap CFO fielding only a handful of calls, the common question is: What can I be doing to improve my relationship with current and potential buy-side and sell-side analysts?

While some argue that the role of an IRO is to serve analysts with a mindset of continuous improvement, it can be useful to stand that question on its head. Given the regulatory changes affecting both the practice of investor relations and the practice of equity research in a broker-dealer or boutique shop, the converse question has equal relevance: What should analysts do to improve their relationships with the IRO?

All analysts are not the same. Most work hard to pursue any potential advantage, such as meeting with management, understanding the features of a new product, or seizing on seemingly insignificant details which, when added to their mosaic, provide critical insights into a company's outlook. This is all designed to give them a leg up on their competition.

Relationships are Key

The advantage, however, goes to those analysts who have mastered the keys to building a strong relationship with management based on industry knowledge, consistency and fairness, and a high standard of practicing their craft. These analysts realize that the key to success on Wall Street is relationships – this is a business built on experience, personal rapport, and access. Like IROs, analysts also seek a continuous improvement in their understanding of covered companies and relationships with management as one of the best ways to add value.

Put another way: Are analysts and IROs antagonists, competitors, or partners? Do companies prefer a sharp analyst or a strong supporter, two things which need not be mutually exclusive? Are IROs and analysts really working toward similar goals?

It's probably easiest to start on the high ground and work our way down. IROs work on the idea of building long-term shareholder value, which is characterized by being fair, sustainable, and reflective of the company's financial and non-financial performance. Analysts, on the other hand, operate with an investment cycle that, in current markets, averages one to two years but has rapidly shrunk as volatility has increased.

While this is regularly seen as an antagonistic relationship, in fact there is much that both sides share in common. Both want investors to have access to the most recent and accurate information. Both want to encourage buy-side access to management. Both have an interest in participating in useful, focused conferences that provide meaningful dialogue with qualified investors.

The devil is in the details. What qualifies as recent and accurate information for the analyst can include the latest opinion from an expert network, clearly not on the IRO's list of references. In other instances, it is not as clear that both share common goals.

The quality of access to the buy side provided by a sell side-hosted field trip can be a point of real difference, as the company may be more interested in long-term investors with low portfolio turnover, while the sell-side analyst is likely to be motivated more by the size of commissions generated by active trading from the buy-side client.

So let us offer interested analysts 10 ways to improve their relationship with the companies they cover.

1. IROs enjoy a dialogue with an analyst who does his homework. An exchange of ideas creates parity and opens the discussion, while nothing galls an investor relations officer more than responding to a question with a page number from the 10-K. The analyst who goes beyond modeling questions to understand the drivers of industry financial performance gains respect. And by the way, don't ask a company to do your research. IROs will send along their best package of information willingly, until it comes to information that touches on a competitive advantage. For the IRO faced with a lazy analyst, patience is a must. As the old saying goes, give a person a fish and they will eat for a day, but teach a person to fish and they will never go hungry.

2. Ask hard questions, not trick questions . . . because generally they are not that tricky. Questions that shift responsibility for the investment decision from the investor to management are frequent offenders. They begin with phrases like "How can you make us comfortable . . ." Management generally plans for these questions in advance. Instead, press hard on metrics and trends. Management expects, and indeed benefits from, handling grounded questions about their business and its outlook. For the IRO faced with a responsibility shift, the key is to stay grounded in your core investment proposition and stay on message. Management can't take responsibility for investment decisions over money they do not manage, but they can let smart investors arrive at their own conclusions based on management credibility and track record.

3. Educate the IRO about your rules, practices, and preferences. How fast can ratings change? Does your firm have a balance of buy/sell/hold recommendations? What types of screens do you use to evaluate your industry? What metrics matter? Oh yes, and then please be consistent. Don't be the analyst who "waits for Godot." For example, if you tell an IRO that the rating is a function of EBITDA margins and they improve but your rating doesn't, you lose credibility. By the way, the buy side likes consistency as well. For the IRO, realize you cannot control ratings, price targets, or estimates, but you can be an advocate for accountability to analysts' self-declared rules.

4. IROs want analysts who respect the process. While a CEO who answers his or her own phone when the analyst calls can be considered a good thing from the caller's perspective, it creates obvious regulatory issues. A responsive and informed IRO can frequently turn a detailed question around, often with better detail, faster than the CEO. Also, analysts who badger well-schooled operating management generally get little for their pains but may not realize the cost they pay in the IRO's office, who must contend with it. On the other hand, a CEO careless enough to answer the phone with an analyst on the other end in earnings season probably gets what he or she deserves. It's the IRO's job to manage that problem and actively enforce the gatekeeping role.

5. Let's talk about credibility. On the company side, this is regarded as the coin of the realm, the most important piece of personal currency an executive can possess. For analysts, being rationally stubborn about an investment opinion creates credibility. But it's equally important to be stubbornly rational, that is, not cling to an investment

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thesis that has lost its relevance. Said one IRO on the subject, "It seems that some analysts publish notes simply to support a rating. There aren't many out there who will admit they're wrong and switch gears. It's been my experience that those analysts who refuse to switch gears after many quarters of 'wrong assumptions' lose credibility with the big institutional investors." For the IRO, there is no divine rule establishing analyst opinions as sacrosanct, so when you encounter irrational arguments from analysts you can certainly include communication in releases and conference calls that refutes such arguments. And there's nothing wrong with not seating those analysts at the best tables for company events as well.

6. Courtesy counts. In a field where information is actively homogenized, gaining an advantage in investing remains a relationship game. These are relationships that can last years, so take the time to introduce yourself. Remember names. Say hello. After the meeting arrange a follow-up conversation. Be a nice person. Be honest. Help where you can, for example, with your insight into trading patterns and activity. For the IRO, the same rules apply, so whenever you interact with an analyst, ask yourself if you've done everything you can in that meeting, call, or e-mail, to build your relationship.

7. A road show is a chance to show off one of your best ideas. To quote one IRO, "An analyst who wants to take a company 'on the road' had best be well versed in the company and supportive of management's story . . . not sit there like a bump on a log or, worse, criticize or challenge management in front of investors." Even worse, an analyst who has assigned a "sell" rating to a company asking to take management on the road is an exercise in disappointment. So when planning a road show, or pitching covered companies to go out on the road, treat it as the important event it is. Do the advance work necessary to determine the interest levels in the cities you plan to target – no one wants to be out of the office for a day just for one or two meetings. Try to plan full meeting schedules, and exceed the expectations of your covered companies. For IROs, build a database of your road shows, keep records of who you met with, and the results. Use that information to improve future trips and help analysts increase the effectiveness of your meetings.

8. By the way, we know that "sell" ratings happen. They can't be popular but they can be understood by the IRO, if not by the CEO. So focus on the upside with the company. What are the triggers to improve? And while you wait, don't ask for a road trip, lower your expectations for a conference visit, and remember to be careful about third-party conversations, because the buy side will share your comments with management. For IROs, make sure you understand the rationale for the rating, and what needs to happen to get the upgrade – and don't be afraid to hold an analyst accountable when you reach the targets for a "hold."

9. IROs appreciate an analyst who doesn't ask obviously inappropriate questions, either of the IRO or of management. The "I had to ask" shoulder shrug generally leaves a poor taste for the next time around. And IROs, it's your job to interject when inappropriate questions come up. Sometimes CEOs are even asked personal questions on their family histories, which is wholly out of bounds. It's the IRO's job to redirect that line of questioning as soon as it arises, regardless of whether it's a requirement of the analyst's firm.

10. Highly valued analysts not only understand the sector but have an informed view of the company and how it has performed across economic cycles. They understand senior management and their management style and preferences. Objective insights add more value: Is the analyst able to interpret the impact of events on a company's financial performance? IROs should also encourage this sort of long-term thinking and analysis. Include performance over longer periods in your presentations, or show a graph illustrating earnings performance through recessions to help investors form realistic expectations of how the company may perform during the next downturn.

Dynamic Change is a Constant

The dynamics of the relationships between IR practitioners and analysts have undergone a great deal of change over the past decade. Where once the regulatory horizon was relatively clear of obstacles, today IROs navigate Regulation FD, Sarbanes-Oxley, and the looming rocks of Dodd-Frank.

Analysts, on their side, are no longer paid by the investment banking transaction but in soft dollars by providing access to management. In this world, the quality of relationships matters more than ever, but it's critical to remember those relationships are a two-way street.

The best IROs will continue to foster relationships with analysts and continually adjust their messaging and delivery methods to meet their needs. The best analysts will be doing the same. If analysts follow just a few of the recommendations on IROs' wish list, their calls could well be the calls management loves to take, rather than the ones they dread. IRU

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