KĒI CONCEPTS
In Strategic Investor Relations
VOLUME 1 – NO. 1

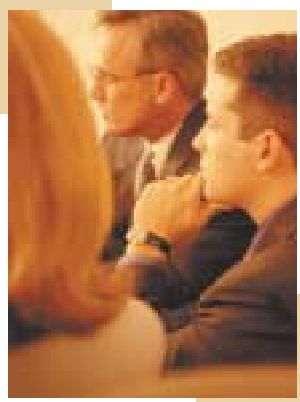
MAKING INVESTOR RELATIONS A STRATEGIC WEAPON

CLOSING THE VALUE GAP

Investor relations is a value creation process. The content, quality, depth and consistency of the information provided by companies to investors and potential investors promote market efficiency and manage expectations for future potential. The value that investor relations can generate may be "missing value," or value that is left unrecognized because the market does not understand the future prospects for a company. Additionally, IR can generate "premium value," or the incremental value a company creates by reducing its risk premium when it provides markets with a greater understanding of its potential relative to alternative investments. In this article, the first in a series, we will illustrate some practical methods you can implement that will enable you to move your company up the premium value curve.

Are you missing a value creation opportunity?

A value gap exists when the market must rely on insufficient information in its efforts to determine a company's future cash flow potential, its risk and its return opportunities. Without a clear understanding of a company's strategy or without a sense of the capability of the organization to deploy that strategy, the market's assessment of value will very likely be less than the true intrinsic value that may exist.



Value is the product of a financial equation that is developed with many assumptions and interpretations. The market's perceptions of a company's strategy, management capability, capacity and creativeness play into those assumptions, as do the prevailing perceptions of the competitive landscape, the strategic opportunities and where your company fits in the picture. If you do not clearly articulate your strategy and it cannot be translated into financial outcome, or if what you do and say are not consistent, then the market by default has to use short term proof points, such as quarterly earnings, to determine whether or not you are on track with the market's resulting expectations for your future. This leads to the destructive quarter-to-quarter "earnings versus estimates" cycle, which forces executive management into short-term

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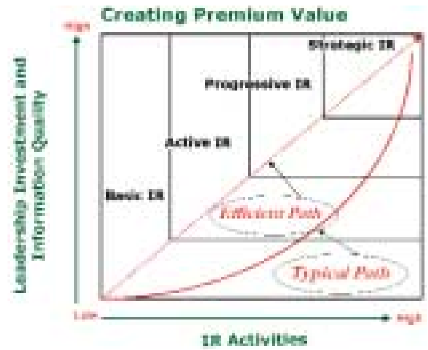
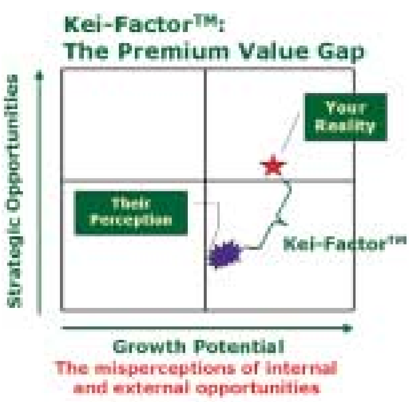


decision making, ultimately undermining a company's strategy and true performance potential.

The distractions and demands of the capital markets also make it very difficult for management to communicate the real value inherent in their assessment of the company's strategy and outlook. To address the gap in value that occurs from the market's lack of understanding, or worse yet, misunderstanding, company managements get busier and busier with IR activities. Busier and busier — yes. More effective? Adding value? Questionable. For example, how much time is now spent with each



quarter's earnings release? There is of course the closing of the books, the analysis, the drafting of the release and the appropriate SEC filing. And now we add a teleconference and web cast to the process, even developing slides and graphs to better demonstrate the results. Possibly there was an earlier release either confirming the potential results or raising or lowering expectations. Then there are the meetings in New York City or other investment centers to meet with portfolio managers and analysts to introduce them to the company, its strategy and outlook and review the recent results.

Deep breath!! Did the market find out what it needed to know? Or did you get the sense that they wanted to better understand how your recent results relate to what the next quarter's results and even the next year's results will look like? Did your audience leave with a clear understanding that there is progress along the path of value creation? Or might they have missed the point, creating a Value Gap? Through our work with many companies, we have discovered that there are a number of very effective means that go beyond the "cookie cutter" tactics described above to begin to close such a gap. We call these activities Strategic Investor Relations.

Addressing the Value Gap is a value creation proposition

A Strategic Investor Relations (SIR) program will effectively capture the components and magnitude of the value gap in order to close it. Resources – with executive management time being a major component – can be directed in a more efficient manner. Two objectives are therefore accomplished: intrinsic value is recognized, and it is achieved in an efficient manner.

By establishing four clearly identified goals, CEOs can define the intent and direction of their SIR program and ensure integration with their public relations, marketing and general corporate communications efforts. Value is achieved by effectively creating an integrated communications plan, which goes beyond required financial reporting and disclosure.

First, achieving fair valuation should be a goal in itself. In order to achieve this, you need to understand where you stand relative to similar investments. Then you must determine how effective your strategy is at deriving value and how consistent your performance is at achieving expected returns on invested capital. The value drivers – financial and non-financial – must be understood and communicated. To enable you to begin to do this, we've created the Kei-Factor™ as a method for measuring the valuation gap and determining progress in creating value through IR. The process for deriving the Kei-Factor includes a percep-

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An Interview with **William A. Teichner**, CFA, Frontier Capital Management

William A. Teichner

UNDERSTANDING A PORTFOLIO MANAGER'S INFORMATION NEEDS

The following interview with Bill Teichner of Frontier Capital Management, the first in a series, is intended to help you understand more deeply how investment professionals use information to develop valuations.

We believe that by better understanding the information needs of Bill and his peers, CEOs can improve their strategic approach to IR. By increasing the depth and quality of the information published and presented by you and your communications team, you can capture incremental value.

Bill Teichner, CFA, a graduate of Columbia University and The Harvard Business School, has been with Frontier Capital since 1992 and currently co-manages Frontier Capital's Small Cap Value portfolios. Here, Bill offers us his research approach, his information needs and preferences – and his perspective on what a company can do to improve the probability of being fairly valued by the market.

Based in Boston, Frontier Capital was founded in 1980 and has approximately $5 billion under management. Frontier Capital's principle for success is its intense internal research using a bottom-up approach. Frontier provides a variety of equity products for pension and profit sharing plans, foundations and endowments, and high net worth individuals. Frontier is an affiliate of Affiliated Managers Group, Inc. (NYSE: AMG).

D. Pawlowski: How do you make your investment decisions? What are you specifically looking for from a company?

W. Teichner: As co-manager with TJ Duncan of the Small Cap Value portfolios, I look at a broad range of industries to find investment opportunities in companies ranging in market cap from $100 Million to $1.5 Billion. We are very interested in meeting directly with company management and are open to being approached by the company. Likewise, many companies are introduced to us through brokerage firms – we have the advantage of being located in Boston, which results in having quite a bit of traffic through the office. As portfolio managers at Frontier, we have the autonomy to select the stocks that we hold in our portfolios – and we tend to be relatively long-term holders. We'll hold a stock as long as the fundamentals of the story remain intact and the valuation is still compelling. We are looking to understand the underlying earnings power of the organization and the outlook for the trend in return on invested capital.

‘ we evaluate not just their answers, but how they respond to our questions ’

DP: What should the management team expect at a meeting?

BT: We have to be comfortable with the management team, so that's a key reason that we want to meet them. We evaluate not just their answers, but how they respond to our questions. Whether or not they are prepared for the meeting itself is important. If they do not have a formal presentation or some means of presenting their strategy and plans to us, it is difficult for us to draw out the necessary information. It also raises questions about their capability. We want to learn several things:

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Do they have a strategy and can they communicate it clearly? Do they know their cost of capital? Do they have return on equity and/or return on invested capital targets? Do they know their ideal capital structure? And how have they positioned the company to address various economic events – such as the current economic downturn? We also consider their reputation and past performance, which are significant indicators of their judgment and capabilities. If it's a new management team, we'll look at their performance in previous roles. We'll do our homework before the management comes in by scouring their financials and understanding their compensation and incentives.

DP: What kinds of information and communication tools are useful for you?

BT: For an initial investment opportunity we use a multitude of sources. In addition to meetings with management, of course we rely heavily on SEC-filed documents, press releases, and sell-side research. We'll look at the company's website to see what information it provides, as well as the annual report and also listen to conference calls. We look as well to see if the company provides the information we need to understand its performance. For example, does it publish a complete income statement, balance sheet and, ideally, cash flow statement when it releases earnings? An abbreviated income statement and balance sheet makes analysis difficult, or untimely, as we have to wait for their SEC filing to see the full financial statements. Often the information is parceled out piecemeal on their conference calls, making them long and ineffective. We expect our analysts to speak frequently with companies – not less than once a quarter. And it usually requires conversations that follow their conference calls. We like to continue to meet personally with management a couple of times a year as well.

DP: How has Regulation Fair Disclosure (Reg FD) impacted your communications with companies?

BT: Companies are now very well informed on Reg FD and will often cite the Reg if they feel they cannot address a question. Primarily, it has changed the nature of discussion of current quarter financials. However, we are looking to understand the long-term earnings power of the company. Reg FD does not impact a company's ability to emphasize its strategy, plans and operational and financial approach to achieving its longer-term goals. It has not changed our ability to estimate the range of possibilities for a company in an improving economic environment.

DP: The Kei Factor is our approach to measuring how a company's IR efforts impact its value. What is your perception of value as it relates to a company's approach to communicating with the capital markets?

BT: I think for the market to properly put a value on a company, it needs to understand what the company is about, and especially understand management – its strategic approach and its competency. Investors need to be kept abreast of any issues, the challenges, and the competitive environment. A company that provides more information, that talks readily about what they are doing and keeps good information flow to investors, everything else being equal, that company would trade at a higher valuation. <

Deborah Pawlowski is president and CEO of Kēi Advisors LLC, a strategically focused IR and financial communications consultancy. Approaching two decades of experience in management, financial communications, logistics, and sales and marketing with various industries, she has worked with a multitude of portfolio managers and analysts to understand the financial and non-financial information needed to fully value potential.

tion audit. Qualitative comments combined with quantitative responses will tell you if market participants see you as being fairly valued or not, and what the components of the value gap are. A peer investment analysis and shareholder analysis are also useful in understanding your relative value and potential. Premium value relative to similar investments is achieved when risk is reduced through a clear understanding of future potential. This can only be accomplished through timely and accurate information, consistently supported through decision patterns and performance. Understanding the Kei-Factor is the first step toward reducing that risk.

Second, CEOs and their IR teams should cultivate a proactive and positive relationship with the investment community. This means understanding their information needs, their decision-making processes, their audience. It entails outreach and conditioning – highly iterative activities. Importantly, conversation with this constituency means a *2-way flow* of information. Regular feedback interviews conducted by a third party after major communications events will help you to know what is not being understood, what you need to emphasize or clarify in your presentations and comments. Reviewing your shareholder analysis, defining the shareholder profile that is best suited for the type of investment you are, and targeting the right audience with which to spend your time will generate greater results and make the use of your time more efficient.

Third, foster a communication environment open to change and progress. Responsiveness, depth of understanding, clarity and frequency, all of which comprise IR competency, contribute to this open environment. This character or trait of a company should be found in all areas, whether dealing with institutional investors, individual investors, customers, suppliers, or employees. The market needs to have the

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MISSION STATEMENT

KEI Advisors LLC is a highly focused, exclusive investor relations consulting firm that provides our clients with creative approaches to managing their communications and relationships with the capital markets. We do this through programs custom tailored to address the audience most interested in their investment appeal in order to enhance shareholder value.

Our clients and experience have ranged from pre-IPO to micro and large market cap companies in manufacturing, medical technology, real estate, financial services, internet and software technology, utilities and energy.

Deborah K. Pawlowski
President and CEO has significant corporate experience in investor relations, communications, marketing and management. Investor relations programs that she has managed have been awarded the prestigious Association for Investment Management and Research Award for Excellence in Corporate Reporting and Investor Relations.

James J. Tanous
Executive Vice President, has over 25 years of experience with a number of publicly traded companies for whom he provides advice on financing, mergers and acquisitions, securities, antitrust and corporate governance matters.

Raymond P. Reichert
Executive Vice President, brings strong experience in the area of federal and state taxes to the team. His experience includes transactional tax planning for large transactions, review and recommendations on corporate structures to reduce tax implications, and negotiations on behalf of corporations with the IRS and state tax departments.

Joseph P. Kubarek
Senior Vice President, provides guidance for companies dealing with public securities offerings, private placements, public and private mergers and acquisitions, venture capital financing, takeover defenses, proxy contests, executive compensation and shareholder matters.

Kayla E. Klos
Vice President, provides in-depth research and analytical skills in evaluating corporate strategic issues and crisis situations including proxy fights.

Vivek Gupta
Research Assistant, applies his skills and studies in accountancy, economics, finance and information systems to research financial performance and market data on client companies, peers, and industries. Applies the financial component of the Kei-Factor™ to determine the magnitude of the gap in market perceptions of value relative to peers and industry groups.

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sense and understanding of how a business will behave with changing currents and shifting winds. Do you have a process for responding to inquiries in a timely fashion? Can your designated spokespersons clearly address your strategy, products, and markets, and translate that into financial outcomes? Are you all telling the same story? Before you started talking – did you ask the interests of the investor or analyst?

Finally and most importantly, your SIR goal should be to establish and maintain solid credibility in the marketplace. Clearly, easier said than done. Financial results and opportunities are what value is created from, that is, the ability to earn an expected return on invested capital. The understanding of the opportunities is the intent of IR. Without credibility, interpretations of your company's opportunities are left to the crystal ball of the market and discounted with a higher risk premium. As a means to measure and monitor the perception of credibility, we have created the "CEO Credibility Coefficient." The CEO Credibility Coefficient is a subconscious, or sometimes conscious, multiplier that is used when a portfolio manager or analyst is reviewing the comments and outlook of the CEO. The coefficient is a topic in and of itself which we will go into in depth in a future issue. The disclosure team within a company knowingly or unknowingly helps an analyst determine the magnitude of the coefficient.

All in all, value is about a business' performance and prospects. However, the outlook can only be valued if communicated clearly, consistently and to the right audience. Content, form, frequency, and, most importantly, credibility, all contribute to providing the market with the information it needs to derive value through first understanding and then closing the value gap.

In future issues you will learn more about the difference between "cookie cutter IR" and "strategic IR" and how to create value through your communications efforts.

Topics will include:

- How to measure your value gap using the Kei-Factor™
- Conveying the significance of your strategy
- Defining your non-financial value drivers
- Determining your CEO Credibility Coefficient and your firm's IR Competency
- Targeting the right investors

We welcome your input and feedback on Kēi Concepts. <

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