

T H E S M A C O U N S E L O R

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COMMUNICATION — AN ART FORM OR A SCIENCE?

We raise the question, “Is communication an art form or a science?”

not because it requires an answer, but to serve as a framework for the discussions in this issue of *The Counselor*. We begin by treating communication in its broadest application, a genre of performance art, if you will. You are expected to develop a winning corporate presentation that inspires an audience of investment professionals. You have been given a virtual blank canvas and now must create a work that communicates the right messages. Where to begin?

The process begins with a sketch. The artist uses his or her imagination to take images from life and satisfy an empty canvas or set them in motion. But we don't have the luxury of a lifetime to learn our craft. The presentation is due next Thursday and you go live the following Monday. Accordingly, we have provided some tips to guide you. Think of them as painting by numbers.

The Counselor then moves to the other end of the spectrum and discusses communication in a highly specialized application – providing guidance to Wall Street. Here, your mastery of topic and technique are indispensable. The environment in which public companies operate today is complicated by the steady stream of new regulations and heightened investor expectations. Standards of corporate governance control much of the content in communications with investors, and all of Wall Street demands that you are rigorous and honest in delivering forward-looking observations. Of course, when you are finished providing guidance, the analyst is still left to complete the

forecast. How they interpret the guidance has ramifications. What you say and how you say it invites risk.

To share his mastery of the topic of providing guidance and help you hone your technique, we invited attorney Howard Berkenblit, from Sullivan & Worcester, for an interview. He discusses his philosophy, theories and firsthand experience on this important subject.

Howard's advice begins with the observation, “The overarching theme [of providing guidance] is consistency.” Consistency.... Precision.... It makes communication seem more like a science. This leads us back to the rhetorical question with which we began. The late French author and filmmaker Jean Cocteau offers us an answer, “Art is science made clear.” We hope you find the discussions on communication of value.

Sincerely,

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A CONVERSATION
ON GUIDANCE
WITH . . .
HOWARD E.
BERKENBLIT

Recently, we met with Howard E. Berkenblit, an attorney in the Business Law Department at Sullivan & Worcester LLP, to talk about the issue of Guidance.

At Sullivan & Worcester, Berkenblit has developed significant expertise in counseling public and private companies involved in equity and debt financings and ongoing corporate finance and securities matters. He previously served as Senior Corporate Counsel for Stream International Inc., now a subsidiary of Solectron Corporation, a provider of customer relationship management and technical support services.

After graduating with a B.A. from the University of Pennsylvania, cum laude, Berkenblit received his J.D., summa cum laude, from Boston College Law School, where he wrote for the Boston College Law Review. Berkenblit is admitted to practice in Massachusetts and holds membership in the Boston, Massachusetts, and American Bar Associations.

Q: We'd like to start by asking for your general philosophy about providing guidance. How do you begin addressing the subject with a client?

A: The overarching theme is consistency. Companies should pick a strategy and follow it. I don't see a lot of companies, particularly small- to medium-sized, giving guidance more frequently than quarterly.

Q: Do you counsel companies for or against providing guidance?

A: There is no single answer. It depends on the company and the industry. Certainly the easiest thing from a purely legal standpoint is to not give guidance, but that is not practical for a lot of companies. Where giving guidance imposes less risk is with companies that have predictable, recurring revenue. Other companies, as a matter of

practicality, feel they have to provide and meet guidance because of analyst coverage and consensus numbers.

Rather than counseling against providing guidance, what you will find lawyers saying is, "Use the maximum number of tools you can to limit your exposure on forward-looking statements." As lawyers, we are concerned with pointing out to the reader of a press release or the listener on a call the meaningful, cautionary language about risks that could cause actual results to differ, making it clear that if, in fact, results do differ, the company is not planning to update until the next quarter. Some companies provide the Safe Harbor disclaimer but fail then to disavow the duty to update the guidance or don't tailor the Safe Harbor to what is actually said. Those are important steps that are sometimes overlooked.

"Companies should pick a [guidance] strategy and follow it."

Q: What is your theory about updating guidance?

A: There's no clear duty to update under current rules, but some companies do. Intel springs to mind, where they're providing updates on their website. I don't see that as a trend. I usually advise against updating unless stock exchange rules require it, as in the case of rumors, for example. Something is always going to change and materiality is a very difficult line to draw. If you aren't consistent, and the one time that you don't provide an update is when there is negative news, plaintiffs can assert you didn't follow your pattern. Some courts have stretched this issue further than others. Absent compelling circumstances, I think it's a dangerous habit to get into.

Q: What about commenting on guidance? For example, a company gives guidance on its quarterly call, and then has a series of investor meetings. At what point do they need to stop commenting on guidance, so that it doesn't become selective disclosure?

A: I'm pretty conservative in that regard. Unless it's within a day or two after the call, you shouldn't comment. I advise clients either to point the analyst to the company's most recent quarterly press release or say nothing at all. Also, as highlighted in a recent SEC enforcement action, the tone at analyst meetings must remain neutral. Otherwise, your comments or demeanor may constitute selective disclosure. One-on-one meetings are always potentially problematic and management must carefully plan in advance what they will (and will not) say and how they will act to avoid violating Regulation FD. You are always going to be questioned in hindsight, after something goes wrong.

If a company is presenting at an industry conference and decides to comment on guidance with the analysts, and if they webcast their presentation, post it on their website and issue an advance press release announcing the availability of the presentation, that's fine, because that complies with Regulation FD.

Q: When should a company pre-release, and what are the events that should go into the decision?

A: Again, it's going to depend on the facts and circumstances. Certainly, the most compelling reason is when you realize you are going to miss your guidance. We all know that can have a dramatic effect on the stock. What has reduced the need for pre-releases is the large movement to using ranges on guidance. If companies give a range and then want to be more specific, they may say on a regularly scheduled call, "We think we'll be in the lower [or higher] end of the range." And sometimes management will say, "Last quarter we gave this range for the year, and we thought we'd be at the high end. Based on the following factors, we think we'll be closer to the middle or lower end." That gives some built-in protection, so that if they're going to miss their numbers they don't have to pre-release.

Q: We've been in meetings with the SEC where they've said that they don't want companies giving specific numbers, because they believe then that the companies are being managed to meet the numbers.

A: One of the biggest dangers in giving guidance is managing earnings to achieve it. Warren Buffett is very much against guidance, even providing ranges, because he feels it takes the focus away from running the business. A number of staff accounting bulletins and other SEC interpretations came out trying to address some of the earnings management issues, like revenue recognition and so-called "cookie-jar reserves." The SEC is aware of the issue of earnings management and has tried to address it. It's still very much on their radar screen.

Q: What about companies changing their guidance strategy? How and when should companies approach that?

A: If possible, you should announce your intentions on the current, regularly scheduled quarterly call as being effective on the next quarter's conference call. This manages expectations. But you also should be prepared to explain why you are changing strategies or no longer giving guidance.

Q: We've seen technology companies scale back their yearly guidance, and just give quarterly guidance, because of a lack of visibility. Some companies have no visibility even in the current quarter, perhaps the result of a hockey-stick revenue model. What are you seeing for those companies, assuming the company has analyst projections out there?

A: Often companies feel the need to say something — even if they can't predict exact numbers. They will list the factors or trends that will influence results and say, "We can't predict what will happen, but we see our markets getting better [or worse] and we expect the general impact to be such and such." Then they protect the forward-looking factors and trends with the Safe Harbor.

Many companies also have stopped projecting non-GAAP financial measures as defined in Regulation G and the new SEC rules that came out in January. Now any time you give a non-GAAP financial measure publicly, you must provide a reconciliation, and usually the most comparable GAAP number has to have equal or greater prominence. Companies have found it harder to give guidance on EBITDA, for example, because there are some GAAP elements that they just can't predict clearly enough to reconcile EBITDA to a forward-looking GAAP number.

Incidentally, if it's in an SEC document, there are additional requirements and, in some filings, prohibitions against the presentation of certain measures. For example, the 8-K that furnishes an earnings

"...point the analyst to the company's most recent quarterly press release or say nothing at all."

release with non-GAAP measures must also explain the usefulness to investors and the purposes for which management uses the non-GAAP measure.

Q: In terms of how you disclose information, would you recommend putting it in a press release, or just on a call, or both?

A: If it's going to be discussed on the call, I like to see it in the press release. There are protections available if you've adequately announced the call and posted certain information on your website, so that it doesn't necessarily have to be in the press release. However, the spirit of the rules is such that if you are putting out a press release about your results and you know you're going to discuss projections, it is a better practice to put them right in

the press release. The potential liability shouldn't be different. If you have a misstatement, and it's not adequately protected on the call, adding the press release shouldn't double your liability.

Q: If given the chance, do you look at the assumptions underlying guidance?

A: Usually. If there are major assumptions, they should be in the press release. We generally don't look at underlying financial models in much detail, but do try to confirm that companies have reasonable and supportable bases for the statements they make. My concern as a lawyer is making sure a company has disclosed what major factors have gone into the assumptions and what events or trends could cause those factors to change.

Q: Studies have suggested that companies giving guidance are more likely to meet or exceed analyst expectations than the companies that don't.

A: What I've seen is a pretty high percentage of companies meet or exceed their numbers as opposed to being below. This may suggest that companies giving guidance tend to be conservative, positioning guidance so it is "meetable" or "beatable." I've attended a number of conferences where the SEC has questioned whether these conservative projections are truly good information for investors. If management is not giving the whole picture, and overly conservative guidance is designed to make the company look good later, is the investor really being served?



"If [guidance is] going to be discussed on the call, I like to see it in the press release."

TIPS TO DEVELOPING AND DELIVERING A WINNING CORPORATE PRESENTATION

Developing and maintaining a corporate presentation that effectively conveys the performance and prospects of your company is an ongoing challenge. Whether yours is a private company trying to attract venture capitalists or a public company courting Wall Street, you must clear the same hurdles. When you finally secure a meeting that has the potential to dramatically affect your company's future, the next step is deciding what presentation you plan to make.

How do you differentiate your company, particularly in these times of tight capital markets? Making a successful presentation starts with successful preparation. Keep in mind the following six steps:

1. Establish Your Presentation Objectives

Knowing what you hope to achieve before you present is more than half the battle. Are you trying to attract investors, reposition the company, or correct misperceptions with existing investors? Establishing clear and focused objectives will help in drafting your slide show or tailoring your existing presentation.

“...customizing the presentation to their interests and understanding.”

2. Focus on the Takeaways

Audience members, on average, can be expected to retain a maximum of three new facts from your presentation. With this in mind, you need to paint a simple path for them to follow. The adage applies here, “Tell them what you are going to tell them, then tell them and

conclude by telling them what you told them.” Your presentation should open and conclude with the reasons to invest in your company.

3. Acknowledge Your Competition

One common mistake that most companies make is to ignore their competition in presentations. A key component of all corporate presentations should be a thorough description of your competitive strengths and weaknesses, and how you plan to capitalize on the strengths and overcome the weaknesses. And at all costs, never apply the “unique” label to your company. By doing so, you set yourself up for the question, “if the market is so hot, why are you the only one in it?”

“Great communicators are not just born that way — they work to enhance their skills.”

4. Understand Your Audience

A common trap many corporate presenters fall into is not anticipating their audience's knowledge base. Presentations that are too technical will lose your audience just as presentations that are too simple will destroy your credibility. Assessing your audience and customizing the presentation to their interests and understanding of your company is a key to success.

5. Recognize Your Non-Verbal Communication

Audience members are judging your presentation by far more than the words you speak or what is on the slide. They are forming opinions based on your physiology — your posture, gestures, and breathing. They are drawing conclusions based on your tone of voice, your tempo

and your speaking volume. Studies show that these elements often account for more than half of the attention your audience is paying to you. Yet many managers rarely take this into account. If you are not excited and passionate about your company and its prospects, how can you expect your audience to be?

6. Practice Makes Perfect

Great communicators are not just born that way — they work to enhance their skills. Nothing helps more than rehearsing. It helps iron out all the wrinkles. It can expose flaws in the material itself and in the person speaking. It prepares you for what questions may be asked and how to answer them. While the importance of rehearsing is generally discounted by senior managers whose time is limited, it is a necessary evil that will pay immediate dividends.



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