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• *Investor Relations*

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Courting the Analysts

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Paul Caulfield
[Email](#)
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Developing an analyst following is the "holy grail" of investor relations, especially for micro- and small-cap issuers. It's a difficult process requiring time, energy, and a good story.

It may become even more difficult in the near future. In both Canada and the United States, legislative and/or regulatory changes are planned that will affect the modus operandi of analysts and their relationship with the investment community.

In the U.S., the [Sarbanes-Oxley Act](#) (SOX) includes provisions for fostering "greater public confidence in securities research, and to protect the objectivity and independence of securities analysts." These provisions, yet to be implemented, include:

- Prohibiting personnel from the investment banking side of a brokerage house from approving or clearing for publication analyst reports;
- Prohibiting analysts from receiving any compensation from investment banking activities; and
- Prohibiting retaliatory moves by investment banking personnel against their own analysts who may have published adverse or negative research reports.

These legislative changes are clearly designed to separate research activities from investment banking activities.

At the same time, in Canada, the Investment Dealers Association of Canada (IDA) has published the final draft of its [Proposed Policy No. 11 on Analyst Standards](#) and is awaiting approval by the various securities commissions. Policy No. 11, which was based on the [Crawford Report](#), includes:

- Recommendations to improve the disclosure of analyst conflicts of interest;
- Best practice guidelines for the improvement of research reports and their issuance; and
- Recommendations focused on the registration of supervisory analysts and the oversight of all analysts.

According to the IDA, the purpose of the new rules is to "improve investor confidence in the marketplace by setting higher standards of practice among analysts." Like SOX, Policy No. 11 includes provisions prohibiting compensation to analysts based on investment banking activities, and prohibiting the investment banking side of a brokerage firm from influencing the research side.

The end result of these new initiatives may well improve the objectivity and accuracy of research reports. It is also expected that separating the investment banking activities from the research department will result in less research activity as a whole. Currently, sell-side research is financed by investment banking; high-profile analysts are effectively sales reps for corporate finance. If cut off from investment banking and its income, sell-side research will have to be financed elsewhere. The most likely source of revenue is sales commissions, generated from retail and institutional buyers. But brokerage commissions have been under increasing pressure from discount and online brokerages. The result? Only the largest and most liquid stocks – the ones generating the highest commissions – will be deemed worthy of coverage. Micro- small- and mid-cap companies will find it harder and harder to acquire traditional research coverage.

Many people think that these changes will signal the rise of the "independent" research firm, perhaps financed by institutional buyers who are too small to be able to afford their own buy-side research departments, or perhaps financed by the issuers themselves.

In the meantime, here are some simple rules for courting analysts.

1. **Know your story** – The first step in any communications initiative is to craft a simple and compelling storyline. Many times, especially with long-established companies, the investment community has misguided perceptions based on old information. If your company has restructured, turned around and/or refocused, the Street may not understand the new, improved reality.
2. **Know the Street's perceptions** – If you're an established company that's been known on the Street, but has somehow gone out of fashion, then a third-party Investor Perception Audit (IPA) may reveal the reasons for your current disfavour. Perception audits can also provide an opportunity for a "soft sell", introducing a company and its story to analysts and portfolio managers who cover or hold the competition, thus stimulating interest.

If you are unknown to the Street, then a full-blown IPA is a waste of time and money. Instead, think in terms of a smaller, third-party survey of sector perceptions. Find out who's in favour and why. Which CEO has the highest credibility rating? Which company runs the best IR program? What are the short- and long-term expectations for your industry? What are the key challenges? What are the key drivers of securities in this sector? Use this information when drafting your key messages and story.

3. **Target appropriate analysts** – Analysts specialize in specific fields – telecommunications, software, mining, consumer goods, financial services. etc. They also may limit themselves to certain market caps – small, mid, large – depending on the demands of the brokerage's own clients. You need to understand both the interests of the individual analysts and their importance and influence within the investment community. Some analysts are "lead steers" and therefore more important to court than others.

A good place to start is by identifying those analysts that cover your competition. A simple phone inquiry might identify the reason they are not currently covering your

stock. There may be a number of reasons:

- Market cap too small;
- Retail float too small;
- Non-performance;
- Lack of available information about the company;
- Perception that management is unapproachable; and
- Sector out of favour.

4. **Understand the analyst's needs** – Analysts cater to their in-house sales force, both retail and institutional. First and foremost, their individual reputations and careers are based on the accuracy of their reporting. They need accurate, timely information. They need access to senior executives. Talk to them. Find out what kind of financial model they run and what you can provide to make their life easier – within the legal limits of disclosure.

By the way, don't ever try to reach an analyst first thing in the morning. Chances are they are desperately reading the press releases that came through overnight and making buy/sell recommendations to the institutional sales force that's working the phones before market opens. They do not want to be disturbed!

5. **Respond quickly** – Analysts are under incredible pressure especially from their buy-side clients. If they have a question, find out the answer as quickly as possible.
6. **Be a knowledge source** – Analysts need information not only about individual companies, but also about the sector. Their reports often include background information on the sector and how an issuer fits into the overall industry picture.

Use every opportunity to position your chief executive as an industry "expert". Make them available for media interviews. Get them invited to speak at industry conferences, which are often

attended by sector analysts.

7. **Be prepared** – Have the right tools available including:

- **Investor Fact Sheet** – A two-page, faxable or emailable summary of the company, its investment highlights, and its forward strategy;
- **Multimedia presentation** – A short – 20 slides in 20 minutes – presentation. The presentation covers financial highlights, operations, forward strategy, goals, and investment highlights. All of this material should be available in hard copy as well. What the analyst really wants to see in a presentation is how the chief executive handles him/herself. Are they entrepreneurial? Do they have a vision of where the company is going? Do they have a grasp of their own financials? Do they understand their industry and the broader picture? Do they inspire confidence?
- **Investor package** – Fact sheet, annual report, current quarterlies, press releases, executive biogs, industry backgrounder, media clippings, sales brochures.
- **IR website** – I've said it before – many times – your website should include all the information, both material and non-material, that an investor needs to make an informed decision about whether to buy, sell or hold your stock. As soon as you get an analyst on the phone, he/she will be doing two things. First, they'll check their Bloomberg terminal for current market position, earnings, etc. Second, they'll be looking at your website. While they're talking to you! It better be simple to navigate, up to date, and inclusive.

Only when you have all this material prepared are you ready to phone analysts. And only after extensive rehearsals are you ready to meet with analysts. Rehearse not only the presentation, but also Q&A. Anticipate the toughest questions and work on the answers – again and again. This cannot be emphasized too strongly.

Studies show that 60% of a buy-side investment decision is based on non-financial factors, and the most significant non-financial factor is management credibility. Your chief executive's ability to think on his/her feet and answer questions decisively, simply, and accurately will be key.

8. **Don't play favourites** – You need to treat all analysts equally, whether they give you a buy or a sell recommendation. Punishing analysts for writing adverse reports may give you some short-term satisfaction, but will damage your credibility in the long-term. And credibility is what IR is all about!

9. **Don't hide the bad news** – Remember the tip about not disturbing an analyst first thing in the morning, because they were desperately trying to absorb all those overnight press releases? Well, if you decide to be "cute" and bury the bad news on page three of your latest quarterly press release and some analyst, in a hurry, misses it, heaven help you. Bad news is just as material as good news and needs to receive equal play, if you want to maintain your credibility with investors.

Also, companies tend to burrow down in bad times, avoiding contact with the investment community. Again, this is not how you build and maintain credibility. Very early in my IR career a portfolio manager said to me, "If a company won't talk to me in bad times, why should I listen to it in good times?"

When you finally do have an analyst following, you'll want to consider the need for a yearly analyst/investor conference, but that's another column.

The next few years will be a challenging time as the market works to recover investor confidence. Issuers will need to keep current on regulatory changes and their impact on the IR process. The issuer-analyst relationship is going to change radically. Yet the need for accurate information about issuers will not diminish and analysts, whether part of a traditional brokerage house, an institutional buyer, or an independent research facility, will continue to play a key role in educating investors.



Paul Caulfield is a communications consultant with an eclectic background as an award-winning television producer, a managing editor, and a writer. He was the author of the ground-breaking report **Under Construction: A Survey of Canada's Information Highway** (1995). He currently provides freelance consulting services through his company, [Mirus Communications Inc.](#)

As senior investor relations consultant, Paul is a hands-on practitioner producing corporate speeches, press releases, IR websites, annual reports, and investor presentations. He has provided financial communications and strategic planning to a number of small- and large-cap Canadian companies.

Email: pcaulfield@miruscom.ca

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