

Don't Hide Your 10K Behind

COMMUNICATING VALUE (OR NOT) TO YOUR INVESTORS

"The Street still doesn't get it." That's a phrase we hear often as CEOs voice their frustration about how investors aren't putting the pieces together and valuing the company properly. The problem is that by complying with today's extensive disclosure requirements, many companies feel they are also meeting all of their investor communications needs. Clearly, the danger lies in confusing legal requirements with the effective communication of a company's vision, value, and investment opportunity to Wall Street.

In the absence of clarity, investors are left to their own devices to distill all this information. It starts with the 10K, a detailed account of the company's financial history for the year. This data heavy document doesn't reveal the value of a company's intangibles. Non-financial assets such as intellectual capital, R&D efforts and brand name value are mentioned, but not elaborated upon. More importantly, the company's long-term vision and the business strategy to turn this vision into a reality are nowhere to be found in a 10K. Major components that will contribute to the company's effectiveness in implementing this strategy, such as management talent, company culture, driven employees and stakeholders, and a loyal customer base, are invisible or muddled. Yet these can be the main drivers of a company's value on Wall Street.

Warren Buffet said it best: "I would like to see an MD&A written as if I were sitting across from the CEO who was telling me the key factors driving value in his company and the kind of issues that keep him awake at night."

THE VALUE OF COMMUNICATING INTANGIBLES

In 2004, Dr. Baruch Lev presented to NIRI the results of his NIRI-Berkeley study that found that over 40% of the S&P 500's market value was found in non-financial factors. The landmark 1993 Ernst & Young study "Measures that

Matter" found that 35% of these factors were in intangibles, and revealingly, the number one factor was the quality of management. And for confirmation, Robert Litan of the Brookings Institute, stated in his 2000 book *The GAAP Gap* that intangible assets account up to 80% of the S&P 500 market value.

For an investor to know the real value of a company, information like market dynamics, corporate strategy, non-financial value drivers and corporate culture must answer three basic questions. "Is it a good business?" "How is the company positioned strategically?" And "What kind of people are running it?"

According to the data from the 2004 NIRI Annual Report Survey, executives identify institutional investors (89%) and analysts (80%) as their primary audiences. Yet what do they want to say to these people? Looking at the strategic intent of the annual report, NIRI found that 81% focused on corporate strategy and 70% on non-financial value drivers, while 57% focused on articulating the reasons why investors should buy or hold their stock. None of these things are communicated in the 10K.

And the investors? According to *The Analyst & The Annual Report* by Gene Mayer (August 2001 NIRI Update) analysts said, "For many companies, the annual report is a missed opportunity..." and "The annual report should become a forum for fine tuning the corporate message." Analysts also indicated "...the message should be unique to each company and must come from the top." The annual "Must establish the vision and strategy and deal directly with challenges."

Thus, the annual report represents the other end of the disclosure continuum—providing the necessary venue for clarification and communication of management's vision. Unlike the 10K alone, it should present a clear sense of the company strategy, culture and vision with the ultimate purpose of enabling investors to understand the company's true value.

A PRIMER ON EFFECTIVE ANNUAL REPORT MESSAGING

Promoting value effectively starts with clarifying your message. First, you need to listen to the questions analysts are asking, listen to what your executives are saying, and listen to what customers are saying about your products and services. From there you can develop a strong messaging platform from which the company can speak. This platform will help you to determine the best way to unfold your company's story, and what visual vocabulary will create value in your investor minds.

Using your corporate messaging platform as a foundation, your annual should have its own resonant message platform from which you can position the rest of the document. What we have learned in the last 25 years in creating hundreds of annual reports and thousands of marketing projects is that it all boils down to effective branding.

The branding process focuses on the core values that lead to effective positioning in your investors' mind, including who you are, what you do, how well you do it, and why you do it. The best companies brand themselves in their investors' minds. Successful brands, like successful companies, stand for something.

How do you determine which core value to highlight in your company's annual report? For the sake of demonstration purposes, let's assume there are three different core value attributes that a company could focus on:

1. Customer Intimate

This represents a deeply customer-centric focus, i.e. the customer first, always. Good examples of this philosophy are Nordstrom and Ritz-Carlton Hotels.

2. Technology Leadership

This represents indisputable technological innovation and execution, like BMW and Intel.

3. Operational Excellence

This represents the ability to make the service infrastructure the key to customer satisfaction, like Wal-Mart and FedEx.

It is critical to make the choice as to which attribute best represents the major value for your company. While there may be more than one, ideally your annual should focus on a single attribute and how its successful execution impacted the year.

The following are some examples of how to develop an annual report messaging platform and create an annual that effectively communicates it.

CUSTOMER INTIMATE

Leap (Nasdaq: LEAP) provides innovative mobile wireless services targeted to meet the needs of customers underserved by traditional communications companies. With the value of unlimited wireless services as the foundation of its business, Leap pioneered both Cricket® and Jump™ Mobile services. 2005 was a pivotal year for Leap, one in which it improved its top-line revenue, while maintaining an industry low cost-per-gross-customer addition. Leap was now recognized as the low cost leader in the wireless industry.

Leap's executive management understood that doing a 10K alone would not be effective in communicating their business model, so they chose to do an annual report to clarify and impact their shareholders by highlighting the power of their innovative Generation Y customer focus. Utilizing a unique dual cover format, the annual gave Leap's brand and business strategy stories equal billing.

"For 2005 we needed to create an annual report that clearly communicated our corporate and consumer brand values/relationships and company culture."

Jim Seines, Leap Wireless International, Inc.

The brand story was presented using vibrant visuals, reflecting the youthful and diversified customer base of the company's Cricket and Jump product offerings. Leap's strategy story was delivered as a straightforward business presentation, with text and charts presented in a clean, crisp format.

The final product was a smart and savvy annual report that allowed the reader to obtain a quick picture of Leap and its product offerings – and a clear message of where the company anticipated garnering its future value. A far cry of what could be achieved with a 10K alone.



OPERATIONAL EXCELLENCE

SYSCO (SYY: NYSE) is the market leader in the North American food service industry. The company distributes from 161 locations across North America to more than 420,000 restaurants, hotels, schools, colleges, cruise ships, summer camps, sports stadiums and theme parks. In 2005 SYSCO sought to highlight the effectiveness of its National Supply Chain Initiative which was designed to elevate and streamline the level of service SYSCO provided to its customers and maintain the company's supremacy in product distribution and customer accommodation.

To illustrate the implementation of this new supply chain initiative, the theme "Our Story Continues to Unfold" was developed. The visual hook was a mix of origami paper sculpture, artwork and customer illustration to describe the role of the Redistribution Centers and how everyone from customer to consumer would benefit from the initiative.

Key to understanding the supply chain paradigm was a large, fold-out spread that mapped its complex structure. This allowed the images to become keys to understanding the roles and relationships between the company and its suppliers and customers.



TECHNOLOGY LEADERSHIP

Invitrogen (Nasdaq: IVGN) offers products and services supporting pharmaceutical and biotech research worldwide. The company provides essential life science technologies for disease research, drug discovery and commercial bio-production with its products found in nearly every major laboratory in the world. In 2005 the company needed to set the stage for its move to get closer to the patient via development of molecular diagnostics, and outline how the company was orienting itself to succeed in this growing market.

The company's technological innovation and excellence was highlighted by using 3-D imagery to capture the reader's curiosity. The theme of "Moving Closer to Understanding" humanized the technology and helped to make the company's complex story approachable.

Through its amazing 3-D imagery, and the inclusion of the latest design in 3-D glasses, the annual report engaged Invitrogen's shareholders in a way that a simple 10K could not, and thereby elevated their appreciation of the company's innovative business vision.



Institutional Investors Value Annual Reports

A study of institutional investors by Rivel Research and Corporate Reports, Inc. in 2004-5 revealed that 56% stated that annual reports were a "great influence" on their investment decision, while 75% of buy-side analysts used it to form an overall impression of the company. In the survey, 69% of the analysts looked to the annual report as they began due diligence, with 67% using the annual as an "owner's manual" for the company's stock. Ultimately, 57% preferred a traditional annual report, with 19% in favor of a 10K wrap, and 12% choosing an ordinary 10K.

ANNUAL REPORTS COMMUNICATE VALUE

These examples demonstrate how branding techniques can be used to successfully position companies. In particular, the use of high impact visual messaging can be used to demonstrate and clarify a company's value to its investors.

Given today's tough Wall Street environment, it's not surprising that IROs are spearheading a rebirth in the printed annual report and its digital pdf cousin. This time it's the foundation of an arsenal of corporate branding tools to communicate non-financial factors driving success. As an integral part of the company's core value messaging, these factors can act as the validators in an effectively designed annual report. One that will impact retail and institutional investors and provide them with reasons to buy or retain their stock. Isn't it amazing that in today's digital society, some of the best tools are the most basic and best proven?

Make your next annual report the one that investors will read.

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Mentus has been providing investor and marketing communications for Fortune 500 and emerging companies across North America for the past 25 years. With an imperative to "listen, create and deliver," Mentus strategically crafts annual reports that successfully establish companies in their markets and on Wall Street.

We are proud of the longevity of our corporate relationships (many of which extend over 15 years) and our ability to be a strategic partner for our client companies. Our staff of seasoned professionals blends creativity with a deep understanding of our clients' industry and investment audiences to ensure we develop annuals that are both memorable and effective. And our Clarity™ process helps to make the annual report process as pain-free as possible. Clear schedules, frequent milestone checks and great client service are part of the plan. The result is an annual that is in shareholders' hands with time to spare.

ANNUAL REPORT RULES OF THE ROAD

LISTEN

1. Determine what the issues are.
 - A. Outsiders' perceptions – analyst, media, competitors
2. Determine what management wants to say.
 - A. CEO, CFO, IRO
3. Determine your audience and what is important to them
4. Evaluate your company, competitors and the industry

CREATE

1. Establish a management team, and approval structure.
2. Establish scope of effort
 - A. Create plan
 - B. Kind of report, budget
 - C. Choose consultant if necessary
3. Determine the single major message you want/need to communicate THIS year to your investors.
4. Create a creative platform to package and deliver that message.
 - A. Develop multiple concepts to establish corporate "style"
 - B. Get consensus on final decision with management

DELIVER

1. Manage copy development
2. Manage photography/illustration
3. Manage production
4. Select and contract with printer
 - A. Get multiple bids
5. Proof and print report
 - A. Arrange delivery to Transfer agents
 - B. Arrange Proxy collation and mailing
6. Distribute copies as per plan
7. Post-mortem evaluation

This may seem complex, but it is a tried and true system with which thousands of companies deliver million of reports every year in a reliable, timely manner.

The best advice that we can offer is to

1. Give yourself enough time and start early and
2. Get help from experts to guarantee success.

listen. create. deliver.

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