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Q&A with Mark Gerstein, Steven B. Stokdyk, Matthew Sherman and Jennifer Sherman

Evolving Director-Investor Communications: Preparing for Your Board's Direct Engagement with Shareholders

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Preparation, two-way communication, targeted proactive engagement and choosing the right director for the job are the keys to a successful engagement strategy, say Latham & Watkins partners Mark Gerstein and Steve Stokdyk in discussion with Matthew Sherman, President, Partner, Joele Frank, Wilkinson Brimmer Katcher, and Jennifer Sherman, Chief Operating Officer, Federal Signal Corporation, and Board Member, Franklin Electric Co.

State of Director-Investor Engagement

Gerstein: How has the volume and depth of director-investor engagement grown and accelerated over the past two to three years?

J. Sherman: We have seen a significant change at Federal Signal Corporation. We have been actively meeting with our major investors, particularly around the issues of strategy and capital allocation. We have also found that many of our investors are much more prepared for those meetings, coming in with very specific questions regarding the direction of the company. We expect that trend to continue.

M. Sherman: If we go back to pre-Enron and pre-WorldCom, directors and management teams could do no wrong; since that time, the power and narrative completely shifted in the favor of the institutional investor to the point where the onus is now on the company to respond to questions of management or governance. That sentiment does not seem to be waning and the rise in activism has only served to compound this reality as there is a heightened interest in challenging the status quo.

Agenda and Rationale for Engagement

Gerstein: In the case of proactive engagement, when there is not a crisis on the table and the goal is more relationship building, are there particular agenda items and topics of discussion being highlighted?

J. Sherman: There are many questions around strategy: operational strategy, capital allocation strategy, M&A strategy, growth strategy, etc. These non-governance topics end up being as or more critical than the governance-type issues.

Gerstein: What are the concerns you hear most often from clients regarding director engagement?

Stokdyk: One of the biggest concerns is when a director inadvertently says something in an investor meeting that is not for public consumption or, in particular, anything that could potentially harm the trust and credibility of the company with the investment community.

J. Sherman: Directors are not management, so the depth of knowledge that a director has regarding an issue inherently is not as extensive as that of a member of management. As a result, there is a real concern regarding the level of preparation.

M. Sherman: These concerns highlight the need to think carefully about the purpose of the meeting and ensure there are significant benefits to the director to engaging with the investor. The topics for the meeting should be limited and decided in advance to ensure consistency with the message being relayed by management and the investor relations team. Practice and preparation are critical.

Preparing for Director-Investor Engagement

Gerstein: How should a company allocate topics between board members, committee members and management, on both a proactive and reactive basis?

M. Sherman: Each company should consider both sides of the equation and evaluate the speaker and the message in light of particular circumstances, such as issues the company is facing, the message it is trying to portray and the intended audience. The key consideration is the company's proposed message and the goals for the meeting.

J. Sherman: Additionally, it is important to consider the skill set, bandwidth and commitment of the potential participants. Federal Signal was fortunate to have a director who was extremely articulate and knowledgeable about the issues and also had the bandwidth and the commitment to assist management through a months-long activist situation. This is extremely important given the amount of training and preparation that goes into participating in these types of meetings.

Gerstein: How do companies make the decision to proactively engage with investors, rather than simply reacting to crisis and other requests?

Stokdyk: Companies are still primarily reactive to particular concerns and situations, but not necessarily as a result of direct investor requests. For instance, a proxy advisory firm, like ISS, may have issued an opinion, shareholder votes on a particular matter may have been lower than expected, or if the company is doing something that is somewhat unusual. In any of these situations, a company may decide that there is an issue that needs to be addressed whether or not an investor also raises it specifically.

M. Sherman: Often times it makes more sense to have one-on-one discussions because, not only do institutions feel like they are getting direct feedback, but also it does not expose that concern to the broader investment base.

Gerstein: Assuming you want to go ahead with a director-investor meeting, how do you decide which investor, and which contacts at that institution, to engage?

M. Sherman: Companies tend to focus on the largest 10 to 15 stockholders and any activist funds that hold a significant amount of the company's stock. Collectively, these institutions tend to own a significant portion of the company. However, the company may be a relatively minor part of these investor's holdings, so there is no guarantee they will want to meet unless there is a specific reason to do so. Companies should also keep an eye on the squeaky wheels – the activists and the antagonists with smaller stakes – who expend a significant amount of time and effort analyzing the company and could instigate something to set off a larger chain reaction.

Gerstein: Is there any particular action a company can take to get their foot in the door of an investor that is not interested in a meeting?

M. Sherman: There are generally two access points within the investing institution: on the investment side, where the relationships are maintained by the investor relations team, and the governance side, where the relationships develop as part of being a public company. It is important to balance these two access points and relationships. Often, a simple offer to meet with a director can get the company some goodwill, even if the institution decides it does not need the meeting. Alternatively, another option that a number of companies are considering is sending directors with management on a listening tour to learn more about the hot button issues for that season.

Gerstein: What are companies doing in terms of director presence at investor day programs, and how are such directors utilized in that context?

M. Sherman: I usually discourage our clients from having directors present at such meetings, as the purpose of the investor days and analyst days is to showcase the depth of the management team and the strategy that management has developed. If you alert attendees that a director will be in attendance, the investors and analysts will simply flood the director, so it ends up having a negative effect on the purpose of the meeting.

Stokdyk: It is important to remember that directors are generally present at a company's annual meeting, so a shareholder should attend the annual meeting for a chance at access to the directors.

Gerstein: What are the essential elements of preparing a director for an investor meeting?

M. Sherman: We are conducting training sessions with directors and management teams on this topic on a daily basis. Much of the preparation is making sure the director knows what is going on at a business level regarding the strategies, operations, record of execution, hot button issues, governance issues and annual meeting votes on compensation or other issues. Time should be spent preparing responses to expected challenging questions about the company's performance, decisions made by management, and plans and strategies being executed – the act of listening to the investor and communicating clearly on these points is key.

Stokdyk: The good news is that many directors are sophisticated, they have a solid baseline of knowledge about the issues that the investors are concerned about and are facing the company – any training often need serve only as a refresher course.. When we conduct training, we spend time on the legal rules, including Regulation Fair Disclosure (Reg FD), proxy rules when in the context of a proxy fight and general 10b-5 insider concerns. We remind the director that anything said can be used in a Schedule 13D filing, proxy statement or tender offer materials, and even if everything is done correctly, things can still be taken out of context.

Gerstein: Should someone accompany the director to a meeting with investors, whether it be counsel, management or a member of the investor relations team?

M. Sherman: A director should not be in a meeting alone, be it on the phone call or in-person. At the very least, another person should attend to listen, take notes and ensure that the meeting stays on-topic. We usually suggest including a member of the investor relations team, who can also help report back to management and the full board on the results of the meeting. For important investors, it may be appropriate to send the CEO or the CFO to the meeting as well, especially if there is a pre-existing relationship between the executives and the investor. However, it is important that the director and the member of management convey solidarity and consistency.

Stokdyk: It is extremely rare for outside counsel to attend such a meeting. Sometimes we see inside counsel in attendance to play a strategic role or address particular issues. If outside counsel attends, it runs the risk of the investor calling off the meeting so they can have their own counsel present. This changes the meeting from a cooperative, educational, listening, learning and relationship-building process to a more adversarial process.

For More Information

Click here to listen to the full panel discussion from the webcast: **Evolving Director-Investor Communications: Preparing for Your Board's Direct Engagement with Shareholders**.

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