

**CORPORATE PRIORITIES:** *Insights from the Rivel Database of Investment Community Opinion*

**February, 2009**

**Topic: Monitoring Shifting “Premium Driver” Priorities**

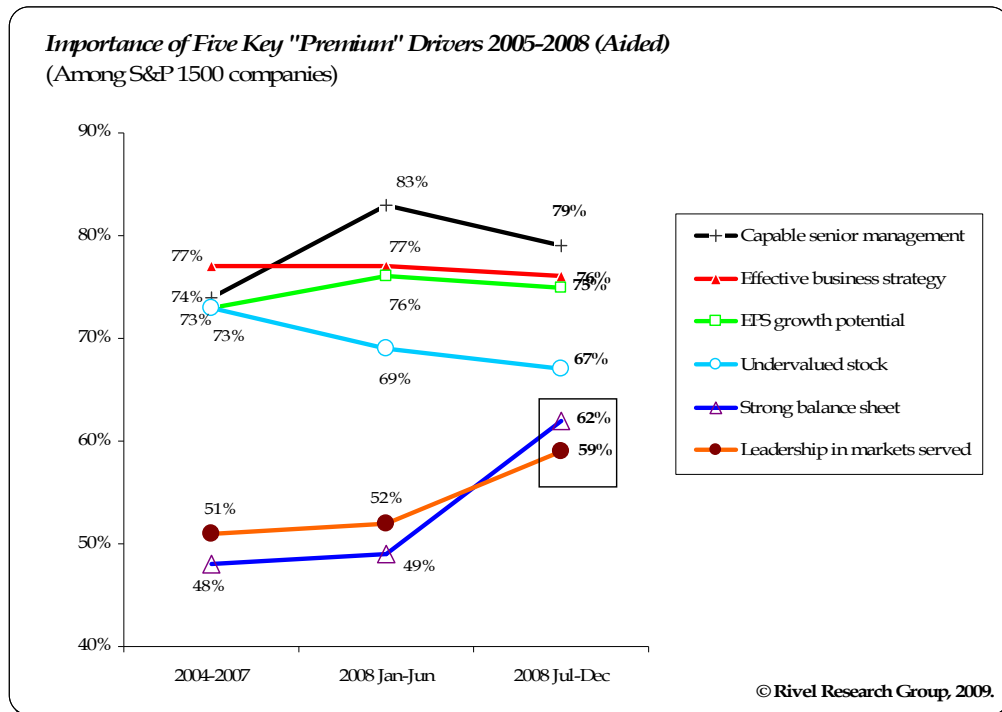
As we indicated last month in our discussion of capital deployment preferences, Rivel has developed an extensive, broad-based repository of data regarding the investment predispositions of sell- and buy-side investment professionals. The most compelling aspect of this insight is focused on identifying and quantifying the drivers (we call them “premium drivers”) which motivate the investment decisions of these key audiences whose attitudes and perceptions establish a corporation’s investment appeal.

Now, with the markets incessantly exploring new 10-year lows and the new administration in Washington groping ever more feverishly for answers to bewildering economic travails, Rivel has developed definitive insight on how these phenomena have (or have not) transformed investors’ informational need-set. We have subdivided our internal database of custom research projects into studies completed in the 2004 to 2007 timeframe, the first half of 2008 and the second half of 2008 to examine premium driver priorities more discretely. The results are clear.

- ❑ Intangible, non-financial factors continue to be the communications themes which public companies can use to differentiate their investment appeal most successfully with investment professionals. The sea change in drivers considered most crucial in judging investment appeal – with management credibility, caliber and strategy superseding earnings growth between 2001 and 2008 – has by no means been reversed by the economic calamity confronting the investment community. In any final analysis, a proven ability to communicate goals in accordance with a well-defined strategy and then executing effectively to achieve them remains the defining variable driving investment decisions.
- ❑ However, the tide has indeed been shifting over the last six months of 2008 and into the beginning of 2009 – not in terms of the overarching significance of management credibility but relating to the factors investors monitor to assess this credibility. Earnings and cash flow certainly are crucial and remain top drivers of long-term investment interest but, for now, some key and, at times, under appreciated considerations – we called them “price of entry” drivers in some of our past discussions of premium drivers – are receiving substantially more scrutiny. Such seemingly second-tier premium drivers (factors which over the years had posted importance scores substantially below more gaudy messages as expanding earnings growth rates or superlative shareholder returns) have been gaining ground. We refer specifically to two factors which often seemed to be taken for granted in the years prior to the current economic malaise – market

leadership and strong balance sheets. Obviously, these “secondary” drivers have always been far more than nice-to-have investment appeals. However, infused with the greater significance imparted by uncertain economic times, strength of market position and the ability to sustain a robust balance sheet are gaining renewed traction as differentiators of investment appeal – well beyond their former role of being simply reality checks quickly referenced to support investment interest that had been triggered by perhaps overly strident claims of, say, earnings growth.

Accordingly, our proprietary data indicate that the percentages of investment professionals reporting that it is extremely or very important for companies to have strong balance sheets and leadership positions in their markets have reached all-time highs in the second half of 2008 – 62% and 59% respectively. While still trailing such desirable aspects of investment appeal as strategy, earnings growth potential or even being undervalued, the gap has narrowed considerably. This trend dovetails nicely with data reported in this space last month which showed the rising importance of paying down debt and reinvesting in the business relative to what appears to be increasingly viewed as the timeworn strategy of share repurchases. And, while the importance of “capable senior management” appears to have fluctuated somewhat over the course of 2008, the 79% importance score achieved in the latter half of the year is still above what it was in the preceding four years – underscoring the heightened significance of consistent execution in accordance with previously articulated goals. The following chart illustrates these shifts in analyst and investor preferences.



Evolving investor preferences are also being reflected in interviewing we are completing coincidental with this memo. In mid-February, Rivel launched our third biennial, nationally representative study of the US buy-side investment community, a survey which tracks current attitudes and investment predispositions of buy-side investors and portfolio managers. Some of the early commentary from this study (scheduled to be completed and released in June of this year) support the issues brought to the fore in this discussion:

*"First [in today's environment] would be balance sheet strength, in other words, low debt. Second is cash flow generation/free cash flow generation. The next would be companies that are positioned for long-term growth. I don't care about the short term, nobody knows what is going to happen short term. We are all just trying to keep our heads above water. It really boils down to who has the best strategy for the long haul."* Buy-side analyst

*"It is balance sheet, balance sheet and balance sheet. You know, we are long-term investors so we are looking at the future potential of the companies. Presently, we are not investing in any company which has a balance sheet which is in danger."* Portfolio manager

*"I would say our biggest emphasis is on assessing companies in terms of their long-term performance goals. We look at the targets that they have set for their performance and evaluate their success in hitting their targets. We are very long-term holders and we want to know what kind of risk they are taking and look at their consistency of past performance."* Portfolio manager

*"We are looking for consistency of record and a strategy with some sustainable advantage relative to peers. And they need to generate a lot of cash."* Buy-side analyst

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In sum, messages delineating market leadership and balance sheet strength may never garner the allure of themes that denote growing earnings and returns. But, in the current market environment, more so than in any recent time that we have studied (and our data goes back nearly 30 years), they actually have enhanced power to go beyond being the building blocks of investment interest and constitute the "tie-breakers" which can be relied on to prompt favorable investment decisions. The goal is to bring these rejuvenated indicators of investment appeal into powerful view by emphasizing progress on any number of strategic initiatives which can serve as the pivotal motivator for investment decisions – including, for example, taking share from competitors, capitalizing on leadership in one market by penetrating relevant adjacent ones, expanding margins, cutting costs, paying down debt or, as the case may warrant, delineating product successes and/or progress moving a product through development toward a favorable launch.