



BY PAUL VITEK

There is no question that the complexity of the Chief Financial Officer position at publicly-traded companies has increased dramatically in the past decade. Increasing global competition, pervasive government regulation and stock market volatility — these are only some of the causes of increasing pressure in the position. The demands on the CFO of the small-cap public company are further magnified by the lack of staff typically found in larger public companies.

Of the many functions of the small-cap CFO, one that is often overlooked due to the *compliance-first* mentality imposed by new regulations (and their associated criminal penalties) is investor relations. When the small-cap company for which I was CFO first traded on a public market, I believed that efficient markets and the vast array of analytical tools available to investors made an active IR program an unnecessary and extravagant expense.

However, it soon became apparent that with nearly 6,000 publicly traded U.S. equity securities available to thousands of institutional investors and innumerable individual investors, small-cap company CFOs must work diligently to raise investor awareness of their companies. While there is little question that in the long run, financial performance will be the primary driver of stock performance, effective communication with investors can ensure full and proper valuation in the market on a regular basis.

In constructing an effective and efficient IR program, it is vital that the CFO understand the objectives of both his/her company and potential investors, know when and where to best communicate the company's strategy and performance, utilize all available outside resources, and build trust in the investment community. At the highest level, the objectives of the corporation and the investor are perfectly aligned: maximizing returns to shareholders through stock price appreciation and/or shareholder distributions. However, within the confines of IR activities, corporate and investor objectives can diverge.

### All on the Same Page: Long-term Focus

To maximize the efficiency of limited resources, it is essential that a company's management team and board of directors be in agreement that long-term stock performance is the primary corporate goal. If the management team or the board is overly focused on short-term swings in the company's stock price, a disproportionate amount of time will be expended on IR activities.

The company's objective with respect to IR activities is to provide investors with the information necessary to construct accurate projections of the company's future while maintaining compliance with disclosure regulations and protecting confidential competitive information (e.g., market initiatives and new product developments). The objective of the investor is to gain as much information from the company as possible to develop valuation models and support his/her investment decisions.

With implementation of Reg FD and the development of online distribution services, fundamental financial information is readily available to all investors. Therefore, the investor wants to communicate directly with company management to gain insight into the quality of the management team, and to understand the potential for growth in the company's earnings and cash flow by increasing knowledge of the company's strategic plan.

Given the limited time available for IR activities, it is important to recognize when investor communications are most effective. While there are external forces that may govern this timing, such as a need to correct incomplete or inaccurate information circulating about the company, investor meetings are most effective when the relevant industry is not out of favor and when the company's stock is undervalued. It is unlikely that a single small-cap stock, absent a particularly unusual or compelling set of circumstances, will overcome the trend of investors moving out of a particular market segment. When the market segment is not out of favor, the CFO should use his/her unique perspective on the company's valuation to determine the appropriate time to be more active with IR activities.

## The Unique View of Small-cap CFOs

Valuation in this case should not be defined as the company's stock trading below a peer group's average using ratio analysis. It is relatively easy to rank comparable securities by Price/Earnings, Enterprise Value/EBITDA or other popular ratios. However, where a company ranks relative to its peers in these ratio analyses is a function of the quality and sustainability of its earnings and cash flow. The CFO's perspective on valuation is unique in that he/she has a better understanding of the company's strategy and cash flow generating capability and therefore the company's intrinsic value, defined as the future discounted cash flows. The art of IR interactions is assisting investors in determining relative valuation by communicating the drivers of the company's future cash flow generating capability and capital needs as thoroughly as possible without disclosing confidential competitive information.

In addition to finding the optimal time to communicate with the investment community, it is important to communicate to the appropriate audience. While it is not a difficult process to identify investors focused on companies with a similar market cap or that have a particular industry focus, the process can be tedious — even when utilizing available computer-based targeting products. This is a process that is well suited to outsourcing.

Effective use of an outside investor relations firm that not only has access to targeting tools, but has developed relationships within the investment community can ensure that the limited time spent meeting with investors is most productive. Choosing the right IR consulting firm is key to effective communication with investors. Analysts and portfolio managers — particularly those that invest in small-cap stocks — are hungry for new and unique investment opportunities. IR firms that have demonstrated the ability to consistently bring these ideas to investors can help gain access to a wider audience.

## Using the Sell-Side

The judicious use of sell-side firms to establish investor meetings is another method of utilizing outside resources to stretch IR dollars. With new rules requiring research to be funded by stock trading activities and with institutional investors using sell-side firms' ability to provide access to company management as a criterion for determining where to allocate their trading activity, the sell-side firms have a big incentive to sponsor non-deal road shows for the companies on which they publish research. Many sell-side firms have in-house personnel dedicated to handling the logistics for these trips and can save participating companies the time and expense of these activities.

However, the CFO must maintain control of the audience for these trips as the sell-side firm may set meetings with the institutional clients that provide them with the most trading activity as opposed to the firms that may be the most desirable long term shareholders from the company's perspective. If there are multiple sell-side firms providing research coverage on a company, they will be competing for management's time (and client commission dollars). The concerns of multiple sell-side analysts can be best managed by rotating the firms with which the company travels with preference given to those firms that best understand the company's business and strategic direction.

Once relationships have been established with investors, the CFO can minimize the time required to communicate with investors by developing trust within the investment community. If the company's strategy is clearly communicated and consistently executed, unplanned communications with investors such as incoming emails and phone calls, will be reduced. This can be accomplished by ensuring that the company's written communications (e.g., press releases and SEC filings) utilize plain English and have a high degree of transparency. When the corporate strategy changes or is not fully executed, it is critical for the CFO to be accessible to investors. Finally, the CFO should be aware that one-on-one meetings with management provide the investor with the most advantageous forum for voicing their comments or concerns relative to the company and should be directly responsive to the concerns that are raised whenever possible.

It is possible to deliver an effective IR program with constrained resources. Investor relations activities can be personally rewarding and challenging for the CFO. These activities provide a respite from compliance and administrative activities and an opportunity to meet with investment professionals that will challenge your understanding of your strategy with their intelligence, energy and inquisitive approach.

Finally, keep investor relations in perspective. The bright lights and big cities that host IR-related activities and events can be alluring, but IR activities — albeit an important support function — are still a *support* function to the primary objective of maximizing shareholder value. IRU

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