

Hit parade

In the wake of the subprime crisis, public companies are laying bare their books in an effort to calm investors. *Terry McWilliams reports*

What does IR do when an extraordinary series of market events suddenly erodes a company's foundation? And what if the depth and breadth of the problems aren't yet measurable?

For the answer, look no further than the subprime mortgage lending crisis now leaving a swath of financial damage across a number of public companies and investment portfolios in the US and around the world. The reverberations are forcing companies to rethink what—and how—they communicate. Fast-moving events, the massive scale of the crisis, the complexity of the financial instruments involved, and the many ongoing unknowns make the IR job extremely difficult.

The subprime crisis has its roots in the housing boom of recent years. With attractive interest rates, reduced paperwork and no down-payment terms, millions of low-income borrowers with less than ideal credit ratings bought homes. Originators sold the bulk of these mortgages to intermediaries, who bundled them into

high-grade bonds. These securities—backed by mortgages, protected against default by complex credit derivatives and cleared by the rating agencies—were gobbled up by investors worldwide.

Heading for a fall

The money-making party was in full swing, but could only last so long. 'At some point, last call had to happen,' says Michael Cohn, founder and president of New York's Atlantis Asset Management.

As US mortgage delinquencies and defaults sky-rocketed, seizing up the collateralized loan market, one of the country's mortgage pioneers, Countrywide Financial, found itself in the epicenter. As the largest US mortgage provider, Countrywide had its own subprime portfolio and was among those facing difficulty obtaining funding for ongoing operations.

Operationally, Countrywide, which for years had prided itself on cultivating relationships with

the investment community, did for analysts what other large banks and institutions hadn't done: it laid out the guts of the company's loan portfolio.

That choice put Countrywide at the 'vanguard of more robust disclosure,' says Jefferson Harralson, an Atlanta banking analyst who covers large financial institutions for Keefe Bruyette & Woods.

Companies responded by opening their books for the world to see. 'The CEOs and CFOs were all of a sudden very available to discuss the intricacies of their businesses,' Cohn says. 'They understood what they needed to do to dispel misperceptions, to make guys like me feel they were on top of the situation.'

Gene Marbach, group vice president of New York IR agency Makovsky + Company, concurs: 'You've got to present the truth; acknowledge that things are tough out there. Be transparent, because when things get better those companies tend to recover faster.'

Wide-open books

Countrywide used its website to offer a breadth of information to investors about its positioning and financial performance, including monthly statistical data, news releases and even a specially written response to a New York Times article describing Countrywide's business practices. The company participated in banking industry conferences but delayed its investor event by eight weeks. Countrywide did not respond to interview requests for this article.

The Countrywide experience helped educate analysts, who began peppering other financial institutions with questions now that they knew where to look. Banks responded with new and more expansive presentations. 'When things are going great and you ask where the subprime exposure is, banks aren't inclined to answer you,' Harralson says. 'But in these times, they're really doing some good work in trying to disclose more into the public realm.'

Even big banks that have largely avoided the subprime mess are getting grilled by investors and analysts, says Judy Murphy, senior vice president and director of IR at US Bank in Minneapolis.

'I think our message has been pretty clear that it is not material for us, compared with some of the other banks,' Murphy says. The bank added commentary to its conference call and addressed subprime questions in a September investor day held to introduce a new CEO and CFO.

Related sectors are also affected. For example, Hovnanian Enterprises, a publicly traded home building company, saw its share price shrink 84 percent from its peak in July 2005. IR director Jeff O'Keefe responded with increased disclosure.

'As Wall Street is demanding more information, we are going back to our operations, gathering the data and packaging it for our investors,' O'Keefe says.

Netherlands-based Aegon, one of the world's largest life insurance and pension companies, felt it was news when there wasn't a negative event regarding its US subprime securities. It issued a news release drawing attention to the fact that none of its subprime portfolio had been downgraded following a review by Moody's Investors Service.

The subscription of subprime effects stretched even farther.

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-Gene Marbach, Group VP
Makovsky + Company

Marbach says Makovsky helped mid-scale restaurant chain O'Charley's respond when an analyst downgraded the company because of potential fallout from rising mortgage delinquencies.

Marbach says O'Charley's incorporated research into its investment presentations showing that two thirds of its customers had income above \$72,000. This painted a picture of a company less susceptible to the downturn.

While these may be well-timed appropriate responses, Cohn still believes that the end of the crisis has not yet arrived.

'This is the time to clear the decks,' he asserts. 'Only time will tell who has not been completely transparent and when the rest of the cockroaches will come out.'