Capital Bridge

OnTarget

CapitalBridge's monthly newsletter focusing on institutional targeting and investor relations

OnTarget – Trends

Targeting the Dividend Growth Investor

In the past, the strategy of focusing on stocks paying continuous and growing streams of dividends has played second fiddle to more popular strategies such as growth and value. But the US Jobs & Growth Tax Relief Reconciliation Act of 2003 ushered in a new era for this strategy. Before the change, dividend income was taxed as just another source of ordinary income, which could be as much as 35%. Beginning in 2003 the maximum tax rate on qualifying dividends dropped to 15%. The result was a huge inflow of money into funds offering this approach. For example, the net assets of Franklin Rising Dividends Fund, managed by Franklin Templeton, rose from $311 million in 2002 to $973 million in 2003 and currently stand at $1.7 billion, according to Morningstar.

The mandate of dividend growth portfolios is to provide a growing level of current income. We would expect therefore that these funds invest in stocks that not only pay dividends but whose dividends have a growth trajectory. CapitalBridge examined the stocks held by a universe of 27 funds whose core strategy is dividend growth. We picked these funds based on the availability of their extensive holdings history. The list includes funds run by managers such as Fidelity and T. Rowe Price.

We extracted the stocks held by these funds and sorted them based on their dividend payment activity. The following categories and percentages emerged:

Dividend Activity	% of Holdings
Positive Growth Rate (Cumulative – Past 5 Years)	78%
Negative Growth Rate (Cumulative – Past 5 Years)	6%
Dividend Unchanged in 5 Years	2%
Initiated Dividend 2-4 Years Ago (with Positive Growth Since)	7%
Initiated Dividend 2-4 Years Ago (with Negative or Flat Growth Since)	0%
Initiated Dividend 1 Year Ago	1%
No Dividends Paid in Past 5 Years	6%

As we would expect, most of the investments made by these funds (about 78%) were in companies that not only pay dividends but also have a positive dividend growth historically. Some of the other categories are quite interesting, however. About 6% of the investments were in stocks that have no record of paying any dividends in the past five years, another 6% had a negative growth trend while the rest had a shorter dividend history, most with a positive growth rate. There also were investments made in companies with shorter dividend history and where the cumulative growth rate of dividends paid was either negative or flat, but these were a negligible number.

The obvious question that arises is – why would these funds invest in companies that have not paid dividends historically, or have investments in companies where the dividend growth is flat to negative? The answer seems to be that they are invested in the hopes that they will either start paying dividends soon, or expect the situation to turn around favorably. To study this issue more closely, we examined the correlation between the shareholdings of these funds and the changes in dividend payment of the stocks. We studied the correlations from two viewpoints.

First, we explored the relationship between the ownership changes in Year 1 with changes in dividend payments in Year 2, changes in Year 2 with changes in dividend payments in Year 3, etc. A positive and significant correlation here would suggest that the funds have been good at predicting the companies' dividend actions.

Second, in the cases where the predictive correlation is either insignificant or negative, we looked at the relationship between the ownership changes in Year 2 with changes in dividend payments in Year 1, ownership changes in Year 3 with changes in dividend payments in Year 2, and so on. This would tell us if the funds adjusted their holdings after the change in dividend in the cases where they were unable to predict the shift in dividend policy.

In the first instance, we find that about 66% of the time the correlation is both positive and significant, in 23% of the cases there is no significant correlation, and in 11% the correlation is negative and significantly so. In other words, the funds appear to be quite good at predicting the movement of the dividend in most of the cases, while less frequently the prediction has been quite poor. In the second situation, we find that about 25% of the time the funds adjust their holdings to reflect the change in dividends after the fact. But in 75% of the cases the lack of correlation persists.

Overall, in majority of the cases the funds either predict correctly or adjust their holdings after the change in dividend policy in the direction of the change.

Clearly the data above do not reveal the fact that some funds are better than others at predicting changes. An examination of the funds reveals that Fidelity Dividend Growth Fund, Vanguard Dividend Growth Fund, and T. Rowe Price Dividend Growth Fund were particularly good at predicting upcoming dividend changes and adjusted their holdings accordingly. There is no fund that is a particularly poor performer, with even most below-average performers getting the direction of the dividend change correct for some stocks they own.

While dividend growth is still not a dominant investment style, if you have a history of dividend growth and the cash flow to continue increasing dividends, conducting outreach to dividend growth managers makes sense. If you're a member of one of the primary dividend growth indices such as the Dow Jones Dividend Achievers index, you may already be a part of many of these funds' investments. If you're not highlighted but have plans to grow dividends faster than the market, however, communication with these investors may be worth your time. The average turnover of dividend growth funds is lower than the investment community's average. Therefore, the individuals across the table from you are more likely to be long-term "owners" as opposed to "renters" of the stock.

If you don't pay a dividend currently but may be initiating one in the future (and haven't announced your policy), an attractive cash flow situation may attract these dividend growth investors to your story. When you do initiate a new dividend policy, make sure dividend growth investors are part of your outreach process.

For more on conducting outreach with dividend growth managers, send us a quick email at targeting@cap-bridge.com.

OnTarget – Best Practices

Options Backdating Revisited – On the Downslope

While nobody seems to have informed the shareholder class action lawyers of the world, the options backdating scandal continues to wane, with only an occasional new investigation announced every few weeks or so. A good source of information on the aftereffects of the scandal has been *The Wall Street Journal*, which keeps an ongoing comprehensive tally on its website of companies that have faced outside inquiries about their options backdating practices. To date, the *Journal* has tracked over 120 companies that have come under some sort of scrutiny for options backdating practices. Of these, 99 have had inquiries or other contact with the SEC, with 53 subpoenas from the Department of Justice/U.S. Attorney's offices. 73 companies to date have restated prior-period operating results or taken charges related to options issuance, with 30 companies seeing departures of executives or directors based on the practice.

Probably the only good news for the corporate world as a whole was that while the issue intensified, notorious shareholder class action firm Milberg Weiss was placed under indictment for an alleged kickback scheme and has seen an exodus of many of its top partners. According to a research piece from litigation research firm Cornerstone, Milberg accounted for about half of the overall shareholder class action suits filed in 2005; this number is expected to drop off significantly this year, as Milberg isn't initiating any new actions as the lead plaintiff. (If you listen closely, you can still hear the lingering sounds of cheering from your in-house counsel...)

Investors in some cases shrugged off these investigations, with many companies making only minor restatements to data from periods as much as ten years old. CapitalBridge tends to look at the response to these investigations from an ownership impact perspective, however. Our October 2006 OnTarget Newsletter highlighted a few investors that had pulled back sharply on their pre-backdating-investigation positions. With third-quarter public ownership data now available, we can see some of the overall effects on holdings of the 106 companies that faced options backdating questions from the end of the first quarter through the end of the third quarter.

Firm Name	Total Value of Holdings in Backdating Companies Prior to Inquiry ($mm)	Value of Shares Sold Through 9/30 in Backdating Companies ($mm)	% Decrease in Position
AllianceBernstein, LP	18,980.10	(3,307.64)	-17.4%
Jennison Associates, LLC	5,495.97	(1,514.02)	-27.5%
Marsico Capital Management	6,429.80	(1,465.03)	-22.8%
Loomis, Sayles & Company, LP	2,131.15	(1,144.53)	-53.7%
MFS Investment Management	3,566.77	(990.17)	-27.8%
Janus Capital Management, LLC	6,105.06	(959.51)	-15.7%
AIM Capital Management, Inc.	3,681.07	(875.41)	-23.8%
Capital Research & Management Company	13,439.02	(801.12)	-6.0%
Relational Investors, LLC	797.69	(797.69)	-100.0%
Deutsche Bank Trust Company Americas	2,506.85	(683.95)	-27.3%

Even more interesting to look at are the large active investors with greater than $5 billion in assets that sold over $100mm to lead to the largest percentage decreases of their "backdater portfolio."

Firm Name	Total Value of Holdings in Backdating Companies Prior to Inquiry ($mm)	Value of Shares Sold Through 9/30 in Backdating Companies ($mm)	% Decrease in Position
Nicholas-Applegate Capital Management	165.41	(165.41)	-100.0%
Friess Associates, LLC	593.52	(406.27)	-68.5%
Marvin & Palmer Associates, Inc.	218.31	(144.72)	-66.3%
Chase Investment Counsel Corporation	291.66	(166.21)	-57.0%
Loomis, Sayles & Co., LP	2,131.15	(1,144.53)	-53.7%
Fred Alger Management	742.16	(329.32)	-44.4%
ING Investment Management Co.	1,230.53	(473.80)	-38.5%
Cadence Capital Management, LLC	304.12	(111.68)	-36.7%
Turner Investment Partners, LLC	1,429.33	(518.65)	-36.3%
State of Wisconsin Investment Board	382.63	(129.68)	-33.9%

Don't be surprised if you see the above investors as event-specific sellers of more than just options backdating situations – these firms may be more likely to move on an accounting or operational question on your company as well, and may require some extra communication to keep them on board during periods of uncertainty.

For a complete list of institutions' holdings of companies facing options backdating inquiries, contact us at targeting@cap-bridge.com.

OnTarget – Firms

Target Firm: Thornburg Investment Management

Targeting Profile

While an on-site visit to this investor is not always easy given its location in off-the-beaten-path Santa Fe, NM, its representatives do often make it out to industry conferences and other events. And, its tendency to hold concentrated portfolios and maintain large long-term equity positions should make it attractive to any IRO looking for a more stable shareholder base. Cash inflows and good performance have led to Thornburg's funds being some of the top performing mutual funds, while its separate accounts appear to have done about as well.

How to Approach

About one-third of its equity assets are focused on the Thornburg International Value Fund, which holds no U.S-headquartered equities; the remainder of the portfolio is spread across attractively valued U.S. investments on the whole. The firm has shown willingness to concentrate its portfolios in top-performing sectors and regions, which is good news for you as a U.S. company (17% increase in U.S. equities assets over the third quarter) as well as in the banking and insurance sectors (largest U.S. purchases over the period include AIG and U.S. Bancorp, both sector leaders with relatively cheap valuations of 12x and 13x forward EPS, respectively). Apache (APA), part of the recently hot oil driller space, is one of the most affordable in the group and attracted a $177 mm investment from Thornburg. Make sure to bring your "comp sheets" and explain your attractiveness versus competitors.

Average equity holding period: 2.0 years

How Not to Approach

The corollary to the firm's willingness to hold attractive valuations in good performing sectors is that it will liquidate poorly performing issues in poorly performing sectors (all but exiting homebuilding and metals/mining in the third quarter, for example) or issues where competitive advantages weaken. The firm appeared to make some relatively good calls in buying techs such as Intel (INTC) at their low points, but it has backed out of those positions in relatively short-term profit-taking.

Largest Portfolios Managed

Thornburg International Value Fund – $7.9b equity – Bill Fries et. al.

Thornburg Value Fund– $2.7b equity – Bill Fries et. al.

Thornburg Investment Income Builder Fund – $1.5b equity – Steve Bolin / Brian McMahon

Thornburg Core Growth Fund– $200 mm equity – Alex Motola / Lei Wang

Investment Potential

Average holdings for the firm at each market cap range:
Giant-cap: ~$102 mm
Large-cap: ~$76 mm
Mid-cap: ~$30 mm
Small-cap: ~$15 mm

OnTarget – Funds

Target Fund: Cambiar Opportunity Fund

Managing Firm: Cambiar Investors, LLC – Brian Barish (303-302-9000, bbarish@cambiar.com).

Targeting Profile

Going through a tough valuation cycle? Not getting the valuation you're expecting from your businesses? Cambiar Opportunity is one investor that might offer a large long-term holding for you if you look "cheap" on relative valuation. Outreach here can help prove that your businesses really do have the intrinsic value the rest of the Street may not be seeing.

How to Approach

Take your relative valuation story here by emphasizing each of your assets that show potential – this could involve comparables work showing your assets against other Cambiar holdings or against a wide range of your peers. The fund has leaned more towards mega-cap purchases recently, with buys of Amgen, Intel, and AT&T, given the overall values created by the underperformance of large caps, but don't ignore the fund if you're a mid-cap as it typically holds similar-sized positions of both mid-cap and large-cap issues. Interestingly, many of the firm's holdings are spin-offs from other long-term holdings – given its low turnover it will tend to hold on to assets that are spun off as long as they're attractively valued – Realogy, AvisBudget, and Western Union are three recent spin-offs that have borne fruit.

How Not to Approach

The fund's average price/sales across the portfolio is a surprisingly low 2.8x, with an average forward earnings multiple of 15, significantly below the market as a whole. If you're trading far above these ranges and won't be this attractively valued any time soon, you may want to skip the meeting, or at least limit the amount of time you spend. Two recent liquidations were Massey Energy and Alcatel, both of which have gone through events that altered valuations drastically (Massey in a proxy contest and Alcatel with the recent purchase of Lucent). Don't be surprised if event-driven catalysts provoke a sell.

Investment Potential

Average holdings for the firm at each market cap range:
Giant-cap: ~$49 mm
Large-cap: ~$42 mm
Mid-cap: ~$36 mm
Small-cap: ~$46 mm

Average equity holding period: 2.6 years

Momentum Players – Hot Stocks vs. Hot Sectors

You've certainly had momentum players involved in your stock at some point in the past – with faster operational growth and maintaining or increasing valuations, most stocks have seen some kind of momentum play catch them at some point in time. Most of the time, however, the more volatile sectors and volatile stocks attract the most attention from momentum investors looking to hitch a ride on gains (you'll rarely find General Electric or Wal-Mart as a real "momentum" investment).

Traditional momentum investments (over and above the short-term, "hold for a couple days" investment so popular in the long hedge fund community) can roughly be broken into two types – investors that are looking to buy "hot stocks" and investors looking to buy "hot sectors." Many momentum investors in smaller investment shops, however, tend not to have analysts that specialize as closely on a particular sector or product type. "Individual stock" momentum investors will look at fundamentals to identify companies that can see earnings surprises or accelerating growth trends, and often use technical analysis to determine entry points. Therefore, while they'll definitely perform due diligence on each investment they make, they're attracted by some of the same characteristics, no matter what the sector. But "sector momentum" investors can afford to specialize more, as some sectors (generally biotechs and other tech stocks) tend to be the best or worst performers over any period.

Here are some large investors (>$1b equity) that played "sector momentum" so far in 2006, adding to their weighting in the hottest sectors in each quarter (Real Estate in 1Q06, Media in 2Q06, and Pharmaceuticals/Biotech in 3Q06). Weightings are defined as % of portfolio in sector / % of portfolio sector comprises of the market as a whole – a weighting of 150 means the firm holds 150% of what it would be expected to hold if it held the market as a whole in its exact proportions. (This method "backs out" the effects of the price increases themselves.)

		1Q06 Top Sector (Real Estate) Weighting			2Q06 Top Sector (Media) Weighting			3Q06 Top Sector (Pharma/Bio) Weighting		
Firm Name	Equity Assets ($M)	12/05	3/06	Chg	3/06	6/06	Chg	6/06	9/06	Chg
Harvard Management Co.	5,829	98	521	**423**	280	295	**15**	38	48	**11**
Davis, Hamilton, Jackson	2,465	0	0	**0**	7	108	**101**	58	126	**68**
Trainer, Wortham &Company	1,824	528	539	**11**	88	141	**54**	68	151	**83**
R.H. Bluestein & Company	1,244	2	60	**58**	54	87	**34**	73	93	**19**
Ramius Capital Group, LLC	1,556	25	125	**100**	39	97	**58**	2	2	**0**
Chase Investment Counsel Corp	6,205	0	0	**0**	0	48	**48**	5	204	**199**
Jennison Associates, LLC	55,933	2	6	**4**	104	159	**56**	78	106	**28**
Canadian Imperial Holdings	6,916	65	99	**35**	94	110	**15**	110	123	**14**
Capital Growth Management	6,235	582	728	**146**	0	0	**0**	12	47	**35**
Oppenheimer Asset Mgmt.	2,475	11	66	**55**	87	91	**4**	65	125	**60**

Sectors are S&P GICS Level 2 and include S&P 1500 SuperComposite stocks.

As you can see, some investors don't have the expertise to make momentum plays in all "hot" sectors, but will still make plays in ones they understand.

Now, to pick out investors playing "individual stock momentum" – CapitalBridge picked out the 25 best-performing stocks in the S&P 1500 for each of the first three quarters of the year. These investors drastically increased their holdings in top performers in each of the three quarters, suggesting that they consistently follow momentum strategies.

Firm Name	Equity Assets ($M)	1Q06 Top Performers Weighting 12/05	1Q06 3/06	1Q06 Chg	2Q06 Top Performers Weighting 3/06	2Q06 6/06	2Q06 Chg	3Q06 Top Performers Weighting 6/06	3Q06 9/06	3Q06 Chg
Driehaus Capital Management	2,679.1	1,331	2,202	**872**	171	640	**469**	165	417	**253**
U.S. Global Investors	1,924.6	94	1,095	**1,001**	48	122	**74**	-	83	**83**
Hoover Investment Mgmt.	1,535.0	507	877	**370**	263	557	**294**	168	237	**69**
Two Sigma Investments, LLC	6,563.8	165	351	**187**	174	644	**471**	120	137	**17**
Columbus Circle Investors	6,687.3	57	587	**529**	20	80	**60**	223	276	**53**
Suffolk Capital Management	1,242.1	10	168	**158**	5	367	**362**	68	153	**85**
Longwood Investment Adv.	1,008.5	-	153	**153**	-	11	**11**	-	336	**336**
Loomis, Sayles & Company, LP	20,768.1	78	97	**19**	70	210	**139**	244	514	**271**
Wall Street Associates	2,316.0	110	222	**112**	55	161	**106**	168	360	**192**
Spark Management, LP	1,140.4	240	504	**264**	266	275	**9**	103	162	**59**

Although it doesn't likely pay to reach out to momentum investors, it does pay to understand their influence on your company at times of peak performance, so that when growth starts to slow you can proactively know what portion of your shareholder base is likely to suddenly sell or disappear.

Send an email to targeting@cap-bridge.com for help in identifying momentum investors in your shareholder base – gratis of course.

OnTarget – Contacts

Recent notable contact moves:

Peter Saperstone (Portfolio Manager) at Fidelity Investments began managing the Fidelity Fifty and FA Fifty Funds in November 2006. He continues to manage the Metropolitan Series-MetLife Mid Cap Stock Index Portfolio, Fidelity Global Opportunities Fund and Fidelity Advisor Mid Cap Fund at the firm.

Kenneth Korngiebel (Chief Investment Officer and Head of Small/Mid-Cap Growth Equity Team), Michael Kosicki (Portfolio Manager), Theodore Wendell (Portfolio Manager) and John Liu (Portfolio Manager) joined Thomas Weisel Partners (TWP Asset Management), Portland in October 2006. All four were formerly at Columbia Management.

Bob Chow (Vice President and Portfolio Manager) at Fidelity Investments will be managing the Equity Income II Fund as of November 2006. He continues managing the Fidelity Advisor Equity Income Fund at the firm.

Philip Ehrmann (Portfolio Manager) joined Jupiter Asset Management in October 2006. He was formerly a portfolio manager at Gartmore Investment Management plc.

Brian Hanson (Vice President and Portfolio Manager) at Fidelity Investments will no longer co-manage the Blue Chip Growth fund as of November 2006. He continues to manage the Fidelity Advisor Strategic Growth Fund and Fidelity VIP Growth Stock Portfolios at the firm.

Mats Guldbrand (Head of Swedish Equities and Portfolio Manager) at AMF Pension was appointed to his current position in October 2006. He was formerly a portfolio manager at the firm.

Erik Voss (Senior Vice President and Investment Officer) joined J. & W. Seligman & Company, Inc., New York, in October 2006. He was formerly a portfolio manager at Wells Capital Management.

To keep an eye on other major contact moves, subscribe to CapitalBridge's IRxtras monthly newsletter containing research updates on movements from contacts, firms, and funds. There is no charge for this newsletter. To subscribe, simply email IRxHelp@cap-bridge.com.

OnTarget – Conferences

The conference schedule gets lighter in December as we hit the holiday season.

Conferences – December 2006

Mon	Tues	Wed	Thurs	Fri
				1 UBS Tobacco Conference – London Merrill Lynch Macro Conference – London
4 Bank of America 2006 Credit Conference – Orlando Credit Suisse Media Week – NYC UBS 34th Annual Global Media Conference – NYC	5 Merrill Lynch 4th Annual Debt/Equity/Commodities Hedge Fund Conference – London Oppenheimer & Co. Contrarian Ideas Conference – NYC Citigroup 17th Annual Chemical Conference – NYC Credit Suisse Aerospace & Defense Conference – NYC Wachovia Securities 10th Annual Global Real Estate Securities Conference – NYC Lehman Brothers Global Technology Conference – NYC	6 NYSSA 10th Annual Homebuilding Conference – NYC UBS Global Gas Conference – London Goldman Sachs Steel Conference – NYC	7 Prudential Equity Group Energy Investor Day – Boston Citigroup 11th Annual Global Paper & Forest Products Conference – NYC Cowen & Company Internet Conference – NYC	8
11	12 NYSSA Biotech/Specialty Pharma Conference – NYC ICBI/Standard & Poor's Risk Management 2006 – Geneva	13 Raymond James IT Supply Chain Conference – NYC UBS Enterprise Technology Conference – NYC RBC Capital Markets Healthcare Conferenc e – NYC	14	15
18	19	20	21	22
25	26	27	28	29

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