OnTarget Newsletter – June 2007

OTN gets specialized during June, looking at biotechs and European regional ownership trends, but first starts with a look at the world of hedge funds.

OnTarget — Best Practices

Hedge Funds – Make Your Strategy Match Theirs

Hedge funds continue to be a hot topic of discussion (including at this year's annual NIRI conference, held last week in Orlando, Florida, which had two sessions focusing on hedge funds). According to various accounts, there are at least 9,000 hedge funds in the market representing perhaps close to $2 trillion in assets, and both of these figures are growing. The absolute return approach of hedge funds means they place a premium on flexibility and opportunism, and hence are often hard to pin down in terms of a single strategy. This focus also means that many of them are not likely to be long-term holders. Yet it would be a mistake to buy into the popular misconception that all hedge funds are volatile, "seat of the pants" investors making large and risky bets – as CapitalBridge reported in June 2006, hedge funds with turnover rates of 80% or below outnumbered those with rates above 150% almost 2 to 1.

In order to fall within private placement rules, an individual hedge fund must have less than 100 total investors (though most managers tend to set up parallel offshore and onshore versions of the same fund to attract both taxable and non-taxable investors). Therefore, to stay within these rules, each individual fund must be managed slightly differently than other funds the investor is operating. This tends to produce managers that are willing to apply many different strategies within the same firm. Larger hedge fund managers that have built reputations and attracted large numbers of assets (such as Pequot Capital or Caxton Associates) are becoming "full service" firms, offering a fund for nearly every single strategy in order to attract pension fund clients. Others focus on a single strategy – distressed debt investors often occupy a single niche in the hedge fund space, not branching widely into other equity or derivative strategies. Information on the strategies offered by each hedge fund is available from a variety of third-party sources, but is often not provided by the hedge fund manager itself – remember, those pesky private placement rules also require that hedge fund managers only solicit investment from "qualified" investors. Some readings of this rule suggest that even displaying hedge fund data on a website is considered marketing to "non-qualified" investors; therefore, you'll rarely find a hedge fund manager that distributes its strategy info on the web or electronically in general.

In light of the sustained interest in this investor class as well as the difficulty IROs often experience when trying to learn more about a specific manager's strategy, we decided to look at a few of the most popular hedge fund strategies and how an IRO might prepare to deal with these market participants.

Long/Short Equity
The largest slice of the hedge fund investor base is comprised of "Long/Short Equity" funds. US managers dominate this segment (mainly based in New York City and Greenwich, CT), followed by Europe (primarily London-based) and Asia (mostly Singapore). These funds generally are biased toward the long side, seeking strong returns but with lower volatility than if they were purely invested long in equities. This hedge fund type is likely to provide needed support and liquidity in your stock but isn't likely to have an extremely distant investment horizon. Your best bet is to communicate with the firm as early as possible about your company but don't expect them to hang around for the long term.

Event Driven
Another significant hedge fund type is "Event Driven." These managers attempt to profit, for example, by taking advantage of pricing anomalies in companies going through bankruptcy or reorganization; from a pending transaction (merger, spin-off, etc.) by going long on one company involved and shorting the other; or from other special situations where the firm believes it can behave opportunistically (earnings surprise/disappointment, hostile bid, etc.). On the one hand, this type of investor can be a boon to your stock if you're involved in a special situation that may make a more traditional investor wary; on the other, the fact that the investment is driven by a specific event means the investment horizon is likely to be short. Furthermore, it's frequently difficult for company management to have an impact on these positions. For all these reasons, minimizing contact between your senior management and these investors is advisable.

A subset of the opportunistic category is the Activist hedge fund, which doesn't so much seek to take advantage of a pre-existing event as it does to create an event itself – by filing a 13D indicating its intention to agitate for change. As we pointed out in last month's OnTarget ("Anatomy of a Hedge Fund Feeding Frenzy"), hedge funds are all the more likely to pile on in the wake of a 13D filing. Bowing to the inevitable, the best offense is a good defense – that is, to already have your traditional money managers solidly behind your company's long-term strategy, with the hope that they will hold onto their shares and reduce the impact of activist sympathizers.

Quantitative

Quantitative hedge funds make up a third important segment of the hedge fund universe. This type covers investors that are Equity Market Neutral, employ Statistical Arbitrage, or otherwise insert significant technology into the investment decision making process. Overall, quantitative hedge funds, like other quantitative investors, are "IR immune" – that is, since their methodology relies heavily on a variety of sophisticated computer programs, hearing from individual company managements rarely has an impact on their decision to buy, hold or sell. In addition, the analytical nature of the approach with its emphasis on historical trends predisposes many practitioners of this strategy toward a lot of short-term trading. Furthermore, these investors tend to have very strict sell disciplines, which can put pressure on a stock.

Other Hedge Fund Styles

The world of hedge fund investing is diverse and other strategies include:

- Global Macro – these funds previously dominated the hedge fund market (remember Steinhardt Partners, Soros Fund Management, or Tiger Management?), but have now been surpassed by other styles, including many noted above. This type of fund hopes to accurately predict price movements of stock markets, interest rates, foreign exchange rates and other "macro" elements, typically using leverage. While some global macro funds would be considered "Discretionary," meaning they also employ fundamental analysis and have a human element, many of these investors tend to be IR immune as the investment decision takes place far above the level of an individual stock.
- Long Only – from an IR communication perspective, treat similarly to a traditional institutional investor.
- Short Only – the best you can do here is to be as transparent and even-handed as possible in your communications to all investors and hope that you don't catch the eye of these fellas.
- Relative Value, where the fund seeks securities selling at a deep discount. If you're a value play, these guys might make sense to court, and they are among the longest holders in the hedge fund realm.
- Convertible Arbitrage – going long on a company's bonds and short on the stock. CapitalBridge tackled these investors in the April 2007 issue of OnTarget; for companies with convertibles, the best approach is to familiarize yourself with some of the largest players in this space – an investor demanding access to management that is likely shorting your equity is probably not worth expending as much time on, compared with other investors.

Overall, then, we can see that there is at least as much variety in the hedge fund universe as there is in the traditional institutional investor community, if not more. So, the key thing to know is this: IROs should treat this investment community segment no differently as a group than any other – do as much research ahead of time as you can to understand whether the fund is a shareholder or not, what their investment style and holding patterns are, whether they are open to communications from companies and if so, what's the best way to approach them, and do not exclude them as a group from your regular, ongoing IR efforts.

By Rebecca F. Updegraph

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OnTarget — Trends

Finding Biotech Investors -- Going Beyond the Granular into the Molecular

Good luck performing traditional fundamental analysis on a small-cap biotech company. One of the fastest-growing sectors in the economy in terms of revenue and margins, the biotechnology space has produced a group of companies with strong investment returns, with the Amex Biotech Index (BTK) outperforming the S&P 500 and NASDAQ Composite for six of the last eight years. The problem for investors is that a specific skill set is needed at the analyst or portfolio manager position in order to effectively invest in these companies – often involving someone with a PhD instead of someone with an MBA. Analysts with a traditional fundamental analysis or technical analysis background are often helpless to determine the risk/reward proposition of early-stage biotech companies, with few traditional valuation, growth, or operational efficiency metrics available for comparison. Beyond that, the illiquid status of many of the smaller biotechs prevents technical analysts from getting involved (technical analysis has its footing in gauging "market sentiment," which is very tough to determine with a small number of market participants).

In reality, methods used by many biotech analysts can be seen as modified versions of the traditional fundamentals-based tools used to measure the potential risk and reward of other investments. A risk profile can be built using characteristics such as potential market for products, leverage (either traditional financial leverage, or often more importantly, the effect of using licensing programs for R&D with one of the large pharma companies), valuation (often just a multiple of balance sheet cash and equivalents), and growth (given that a CAGR calculation really only looks at the beginning and ending period, the total time to market, often measurable by regulatory phase, along with the potential market size, can be used as a growth measure).

Turned in the other direction, this approach can give some tools to the biotech IRO seeking to target new investors that are interested in similar companies. CapitalBridge maintains data on the current regulatory status of the top program (either currently on the market, or "nearest-to-cash-flow") in US biotech companies' pipelines, and we review valuation data from S&P's CapitalIQ and other characteristics that can measure a biotech issuer's potential. By looking at this data for issuers, and cross-referencing biotech investors' holdings over a period of time, it becomes possible to place a particular issuer's risk/return profile in the context of a portfolio, and develop institutional targets.

Investors in Early Development Stage Biotechs

Top Holders by $M			**Top Buyers by $M**	
Firm	**Top ProgramPhase I & II Invested ($M)**	**Top Program Phase I & II % of Port**	**Firm**	**Net Increase in Phase I & II Holdings ($M)**
Fidelity Investments	1,593.0	35%	Wellington Management Company	105.3
Wellington Management Company	1,001.1	25%	Third Point, LLC	91.3
T. Rowe Price Associates, Inc.	595.7	20%	JPMorgan Partners, LLC	68.5
OrbiMed Advisors, Inc.	418.8	31%	D.E. Shaw & Company, LLC	45.6
Third Point, LLC	329.0	58%	JPMorgan Investment Management	44.5

Overall, the universe of biotech institutional investors leans heavily towards those with drugs on the market (53% of all institutional dollars in biotechs are held in companies that have a product on the market, with 23%, 19%, and 2% at Phases III, II, and I, respectively). For an early-stage company, finding investors such as OrbiMed Advisors that have a propensity to hold companies with farther-out return profiles, with top programs at Phase I or Phase II, is often the best use of time.

Investors in Cheaply Valued (<3x cash/equivs) Small-/Mid-Cap Biotechs

Top Holders by $M			**Top Buyers by $M**	
Firm	**Invested in <3x cash ($M)**	**% of Port**	**Firm**	**Net Increase in Holdings <3x Cash ($M)**
Fidelity Investments	410.2	8%	Pictet & Cie (Europe) SA	106.7
Federated Investors, Inc.	359.1	24%	Och-Ziff Capital Management, LP	84.6
Wellington Management Company	340.6	8%	Glenview Capital Management, LLC	51.9
Baker Brothers Advisors, LLC	232.5	24%	Third Point, LLC	45.6
OppenheimerFunds, Inc.	190.4	20%	Harvest Management, LLC	45.4

Valuation for early-stage biotechs tends to be viewed as a multiple of cash and equivalents (or an extension of the "cash burn rate"). Companies trading at a high multiple of cash tend to be viewed as having the best prospects, while at the other end of the valuation scale companies trading below cash can be looked at as attractive acquisitions, event-driven candidates, or just pure value plays (in the same way that Graham and Dodd, the fathers of value investing, suggested investing in companies trading below balance sheet cash).

Investors in Small-/Mid-Cap Biotechs with Top Programs in Oncology

Top Holders by $M			**Top Buyers by $M**	
Firm	**Invested in Oncology ($M)**	**% of Port**	**Firm**	**Net Increase in Oncology Holdings ($M)**
Fidelity Investments	1,414.9	31%	Capital Guardian Trust Company	210.1
Wellington Management Company	1,211.3	31%	Wellington Management Company	191.4
ClearBridge Advisors, LLC	848.9	73%	ClearBridge Advisors, LLC	190.9
Capital Guardian Trust Company	806.3	94%	Fidelity Investments	161.1
OrbiMed Advisors, Inc.	598.1	44%	Brookside Capital Investors, Inc.	123.1

Within the specialized biotech space, analysts/PMs can focus at an even more granular level, sometimes specializing in infectious disease programs, oncology programs, or other types of drug therapeutic indication. Finding investors that have a particular focus or expertise in your program space can also bear fruit in terms of maximizing your time spent attracting new investors.

In sum, "getting molecular" on the portfolios of biotech investors can help you find fertile grounds to tell your investment story. The IRO's job with a biotech issuer is inherently different from other traditional investments, with disclosure and transparency being what it is. The lack of quantitative measures for evaluating companies, however, leaves space for more qualitative analysis, and an excellent IR program, presenting this information to the most relevant investors, has proven to be the most successful approach.

By Jeffrey Nisenson and Brian C. Matt, CFA

Jeffrey Nisenson is a vice president and head of CapitalBridge's biotech/healthcare market surveillance group, providing consulting services to both early-stage biotech and large-cap pharma issuers. He can be reached at jeffrey.nisenson@cap-bridge.com. Brian C. Matt, CFA, is a vice president and head of CapitalBridge's institutional targeting group. He can be reached at brian.matt@cap-bridge.com.

OnTarget — Analytics

Institutional Cross-Ownership in Europe

As a listed company in the developed markets of Europe you probably have a significant portion of your shareholders based in either the US or the UK. CapitalBridge research shows that on average, the proportion of share ownership in the US and UK for companies on the Continent is between 42% and 54% depending on the size of the company (the smaller the company, the smaller the percent owned in the US and the UK). Within Continental Europe, the ownership distribution varies by country depending on some obvious and some not-so-obvious factors.

Investor Domicile	Company Domicile										
	Austria	Belgium	Denmark	France	Germany	Italy	Netherlands	Norway	Spain	Sweden	Switzerland
Austria	17.7%	0.3%	0.3%	0.2%	0.5%	0.3%	0.5%	0.4%	0.1%	0.1%	0.4%
Belgium	2.5%	41.3%	0.7%	2.2%	2.3%	3.1%	4.3%	0.9%	3.3%	0.4%	1.3%
Denmark	2.2%	1.7%	75.7%	1.1%	1.9%	0.7%	0.6%	5.1%	0.3%	0.2%	2.2%
France	19.8%	22.6%	3.0%	67.6%	16.8%	22.8%	19.5%	6.4%	13.8%	2.3%	7.8%
Germany	26.2%	15.9%	5.1%	13.6%	51.6%	20.5%	23.0%	23.0%	29.0%	4.1%	13.5%
Italy	1.9%	1.2%	0.5%	2.0%	2.6%	34.3%	5.2%	1.3%	7.3%	1.5%	2.5%
Netherlands	9.8%	5.3%	1.4%	3.4%	5.6%	6.3%	33.4%	7.5%	3.5%	1.9%	6.4%
Norway	1.2%	2.4%	3.4%	1.4%	1.4%	1.6%	0.5%	35.8%	1.0%	2.1%	2.3%
Spain	0.3%	1.2%	0.1%	1.4%	1.8%	1.6%	2.3%	2.9%	33.2%	0.4%	1.0%
Sweden	4.6%	0.8%	4.6%	1.2%	3.2%	1.7%	2.5%	9.9%	0.4%	81.5%	2.1%
Switzerland	7.1%	5.4%	4.2%	4.9%	11.2%	6.2%	7.4%	4.6%	7.9%	0.5%	59.2%
Other	6.9%	2.0%	0.9%	1.0%	1.1%	0.8%	0.8%	2.2%	0.2%	4.9%	1.4%

** Some countries like Luxembourg were not included because of the lack of statistically significant data*

The table above shows the regional institutional cross-ownership in Continental Europe as a percentage of total institutional ownership identified in the countries shown. We utilized CapitalBridge-sourced shareholder identification information to remove any biases (regional) inherent in public ownership filings. Regional distribution is linked to the extent of assets managed in the home market. For example, Austria is the only country in the table where the home market doesn't represent the single largest holding; but, Austria is also the country with the least assets managed. Sweden and Denmark top the table with over 75% each of the shares held in the home market. This is due not only to large investments by local independent institutional investors, but also to major investments by government funds such as state pension and retirement accounts. Disclosure levels explain some of the subtler differences. For example, in France the wide availability of share registers plus the TPI (Titres au Porteur Identifiables) reports covering the bearer shares helps identify almost every home market share, compared to Switzerland where shares are not always registered and Swiss bank secrecy laws make shareholding information less easily accessible.

Regional shareholder distribution often times indicates where the potential lies in targeting new shareholders. While the US and the UK remain the two most attractive countries for road shows outside the home market, if your Continental European shareholder base varies significantly from the distribution above, you may have untapped interest closer to home.

By Sudarshan Setlur

Sudarshan Setlur is a vice president and head of product development in the international market intelligence group at CapitalBridge. He has previously written on targeting dividend growth investors in the August 2006 issue of OTN and European ownership distribution in the December 2006 and May 2007 issues. He can be reached at Sudarshan.setlur@cap-bridge.com.

OnTarget — Firms

Target Firm: Oechsle International Advisors, LLC

Targeting Profile

The firm is a global investor, in the large- to giant-cap GARP-oriented equity space; it looks for inefficiencies within and between international equity markets. While the firm's assets are only marginally allocated to domestic securities, the investor presents a strong opportunity for European-based companies, with nearly 90% of its assets allocated to this investment contingent. Companies may choose to package up a visit with other Boston-based investors possessing a strong international portfolio overlay, such as Fidelity Investments.

How to Approach

Of particular note, the firm's largest fund exposure lies in the HSBC Investment Solutions plc-European Growth Portfolio. Expect the firm to dig deeply into its favorite sectors (currently financials and materials) while diversifying to manage risk across various countries and companies. The investor has a propensity to keep its sector weightings in motion, with its current favorites being the ordinary shares of BAE Systems Plc and Whitbread Plc.

Average equity holding period: 2.6 years

How Not to Approach

If you're not at least moderately leveraged, you'll probably fall outside this investor's profile (56% debt/capital across the full portfolio). Moreover, the investor prefers dividend paying stocks, with its firm average (2.88%) exceeding that of the S&P 500 (1.80%), mirroring the higher yields of many European blue chips.

Largest Portfolios Managed

HSBC Investment Solutions plc-European Growth Portfolio
Williamsburg Investment Trust-Jamestown International Equity Fund

Investment Potential

Average holdings for the firm at each market cap range:
Giant-cap: ~$11mm
Large-cap: ~$8.8mm
Mid-cap: ~$4mm
Small-cap: ~$2mm

OnTarget — Funds

Target Fund: Neuberger Berman Genesis Portfolio

Managing Firm:

Neuberger Berman – Robert W. D'Alelio (212 476 5883, rdalelio@nb.com), Judith Vale (212 476 5892, jvale@nb.com)

Targeting Profile

If you are looking for a larger, aggressive growth-oriented fund, the Genesis Portfolio is not your fund. This fund has a low 20% turnover rate and primarily invests in small cap ($1.5 billion or less at the time of the purchase) companies across all industries that are undervalued and whose current product lines and balance sheets are strong.

How to Approach

The managers of this fund are intrigued by companies with managements that have proven that they are able to grow through their own financing and have a solid business outlook. If you are a highly profitable, less-risky-than-the-S&P-average company that generates free cash flow, then you should approach this fund no matter what industry you are in. The fund maintains a very cautious market outlook, which is evident by its stock picking. The average holding period for the fund is five years, therefore the managers are not always looking for new picks – so don't necessarily expect an immediate investment after telling your story.

How Not to Approach

The managers will not buy stocks with over $1.5 billion in market cap, but have been keeping the "winners" for years, leaving more than half of the total portfolio dedicated to mid-cap stocks. The past has indicated that they have maintained picks with long-term growth in the energy sector and healthcare sector, and mixed this growth potential with some more defensive stocks.

Investment Potential

Average holdings for the firm at each market cap range:
Large-Cap: ~$142 mm
Mid-Cap: ~$96 mm
Small-Cap: ~$50 mm

Average equity holding period: 5.0 years

OnTarget — Contacts

Recent notable contact moves:

Alice Gaskell (Director and Portfolio Manager) at BlackRock Investment Management UK Ltd. began managing the Merrill Lynch Continental European Fund, Merrill Lynch European Dynamic Fund and the Merrill Lynch Continental European Fund. She continues to manage the Merrill Lynch IIF - Euro Markets Fund.

Kenneth James (Research Analyst) joined Robert W. Baird Group Ltd. in May 2007, covering the financial sector. He was formerly a research analyst at Midwest Research Securities Corporation.

Stephen Kelly (Portfolio Manager) at AXA Framlington Group Limited began managing the AXA Framlington Global Technology Fund in May 2007. He continues to manage the AXA Framlington Managed Growth Fund.

Mark McKechnie (Research Analyst) joined American Technology Research, Inc. in May 2007, covering the technology sector. He was formerly the founder and a portfolio manager at McKechnie Capital Partners.

Daniel Moses (Managing Director and Senior Research Analyst) joined Longacre Fund Management, LLC in May 2007. He was formerly a research analyst at Credit Suisse First Boston Fixed Income.

Karen Umland (Vice President, Head International Portfolio Manager) at Dimensional Fund Advisors began managing the International Social Core Portfolio in May 2007. She continues to manage the Canadian Equity Small Cap Pool, DFA Asia Pacific Small Company Portfolio, DFA Continental Small Company Portfolio, DFA Emerging Markets Portfolio, and DFA Emerging Markets Small Cap Portfolio, among others.

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 June calendar is packed with conferences.

Conferences – June 2007

Mon	Tues	Wed	Thurs	Fri
				1
4 Deutsche Bank Media & Telecom Conference – NYC Goldman Sachs Gaming, Lodging & Restaurants Conference – NYC	**5** Deutsche Bank Japan Conference – Tokyo Credit Suisse Global Oil and Gas Conference – London Lehman Brothers Industrial Distribution Conference – NYC Merrill Lynch Agricultural Chemicals Conference – NYC Merrill Lynch TMT Conference – London RBC Capital Markets Energy Conference – NYC Sidoti & Company Emerging Growth Institutional Investor Conference – Boston, MA	**6** Citigroup Utilities Conference – Charleston, SC Credit Suisse Environmental & Engineering Services Conference – NYC Lehman Brothers Global Services Conference – NYC Piper Jaffray 27th Annual Consumer Conference – NYC Stephens Spring Investment Conference – NYC UBS Global Basic Materials Conference – London	**7** Bear Stearns Biotech Confab – Boston Merrill Lynch US Media Conference – London	**8**
11 Bear Stearns Technology, Communications, Internet Conference – NYC Deutsche Bank Global Consumer & Food Retail Conference – Paris Goldman Sachs Global Healthcare Conference – Dana Point, CA JPMorgan Basics & Industrials Conference – NYC	**12** Keefe, Bruyette & Woods Mortgage Finance Conference – NYC Merrill Lynch Global Transportation Conference – NYC Morgan Stanley Small Cap Conference – NYC	**13** Credit Suisse Software Conference – Boston RBC Capital Markets Mining & Materials Conference – Toronto Needham & Company Biotechnology & Medical Technology Conference – NYC Thomas Weisel Partners 2nd Annual Alternative Energy Conference – NYC	**14** Gabelli & Company Dental & Veterinary Conference – NYC	**15**
18	**19** William Blair & Company 27th Annual Growth Stock Conference – Chicago	**20** Deutsche Bank German Corporate Conference – Frankfurt, Germany Jefferies & Co. Financial Services Conference – NYC Piper Jaffray London Health Care Conference – London	**21**	**22**
25 UBS Taiwan Conference – Taipei Wachovia Securities 17th Annual Nantucket Equity Conference – Nantucket	**26** Jefferies & Co. Healthcare Conference – NYC	**27** Cowen & Company/ISI 9th Annual Health Care Policy Conference – Washington, DC RBC Capital Markets Energy Infrastructure & Trust Conference – Toronto	**28**	**29**

This calendar shows a sampling of investment community events held around the world during the month. Source: FactSet CallStreet, LLC

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