

MARKET PERCEPTION INDEX (MPI)

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CRITICAL THINKING AT THE CRITICAL TIME™

MARKET PERCEPTION INDEX (MPI)

Companies dedicate substantial resources to communicate their strategies, business models and investment propositions to the financial community with the goal of optimizing their valuations. However, these communications often miss the mark because management teams do not fully understand the perceptions of investors and analysts, and as a result they tell an investment story that is misaligned with what is being rewarded by the market.

What drives valuation in the financial markets is an extremely complex calculus based on the relationship between realities and perceptions across the continuum of time from the past to the present, culminating in expectations for the future. Certainly, past and current performance matters, as it establishes the framework for assessing the future. But since the market is a forward-looking discounting mechanism, gaps between internal and external perceptions and expectations often lead to a suboptimal valuation.

Those perceptions affecting valuation are multifaceted, not binary, and most companies do not have a comprehensive understanding of the interplay among the many dimensions of perception that exist about them. Nor do they understand which perceptions are most influential in ultimately driving valuation.

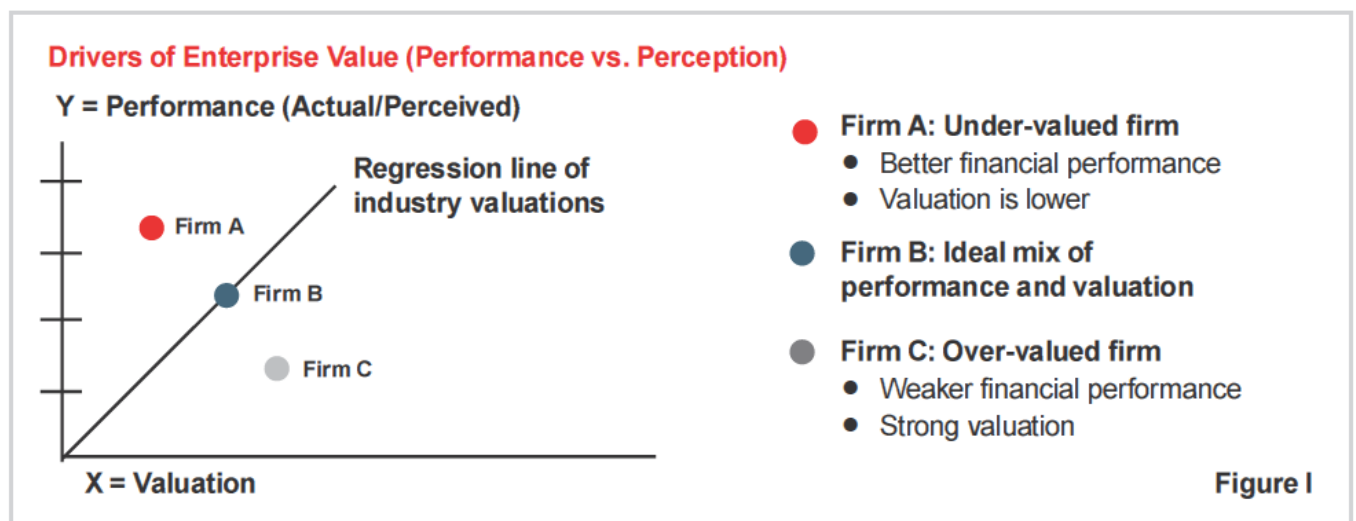
It is with this in mind that FTI Consulting developed the Market Perception Index (MPI) as a strategic framework designed to help companies optimize their enterprise value by better understanding the drivers of valuation and the intangible factors that account for either undervaluation or overvaluation within the context of their industry.

Discussion

Over the arc of a publicly traded company's lifetime, its valuation can shift between a premium and discount based objectively on actual performance and subjectively on intangibles such as investor conviction regarding competitive position, management credibility, visibility into future performance strategy and other variables.

The following chart illustrates this concept in terms of an industry valuation landscape in which there is a positive correlation between performance as measured by specific key performance indicators (KPIs) and valuation. Multiple data points within the peer group produce a regression curve on the graph indicating fair valuation for any given level of operating performance. For the purpose of this discussion, we delineate three hypothetical companies, A, B and C, on the valuation/performance continuum relative to the industry curve.

As illustrated in Figure I, Firm A is afforded a valuation that does not reward its performance relative to the peer group; it is undervalued. Firm C, despite underperforming Firm A, receives a higher valuation from the market and is overvalued. Firm B lies on the regression line, so its valuation and operating performance are consistent with the norm as defined by the universe of industry peers.



The gaps relative to fair value are problematic for both A and C. For Firm A, the obvious problem is that valuation can increase the cost of equity capital, potentially hindering its ability to finance growth and business development in the future. With overvaluation a seemingly high-class problem, Firm C on the other hand receiving a premium valuation from sources that are unrelated to performance. The risk is that those subjective sources could change quickly for a number of reasons (many outside of the company's control), and the reversion to fair value could be abrupt. The rapid change in sentiment could, in its own right, cause investors question their assumptions of future performance.

The interplay between valuation and performance is complex and powerful. It is complex because valuation determined by the decisions and actions of innumerable independent investors who are likely to be focusing on different aspects of the company in question. It is also powerful, as a small shift in performance, when magnified through the leverage of a change in the valuation multiple, can generate a substantial increase or decrease in enterprise value. This, in itself, can be self-reinforcing as share volatility can impact investor confidence, further exacerbating the multiple they are willing to give an earnings (or cash flow) stream. Often wonder, "What am I missing?" following an unaccountable movement in a stock. This can seriously undermine their conviction, causing them to question their fundamental assumptions on a company and assessment on its worth.

Two questions arise from this discussion: What performance is the market rewarding, and what is driving intangibles affecting valuation? Since Firms A and C lie apart from the regression line, the factors that for their valuations are not based solely on performance. Instead, their valuations are based on intangibles, including perceptions.

By understanding what aspect of performance the market is rewarding and the factors behind the intangibles leading to higher valuations, a company can devise a communications strategy that properly positions on the performance/valuation continuum. In doing so, perception around the company's intangibles will be optimized and can thereby generate a demonstrable impact on enterprise value.

FTI Consulting Market Perception Index

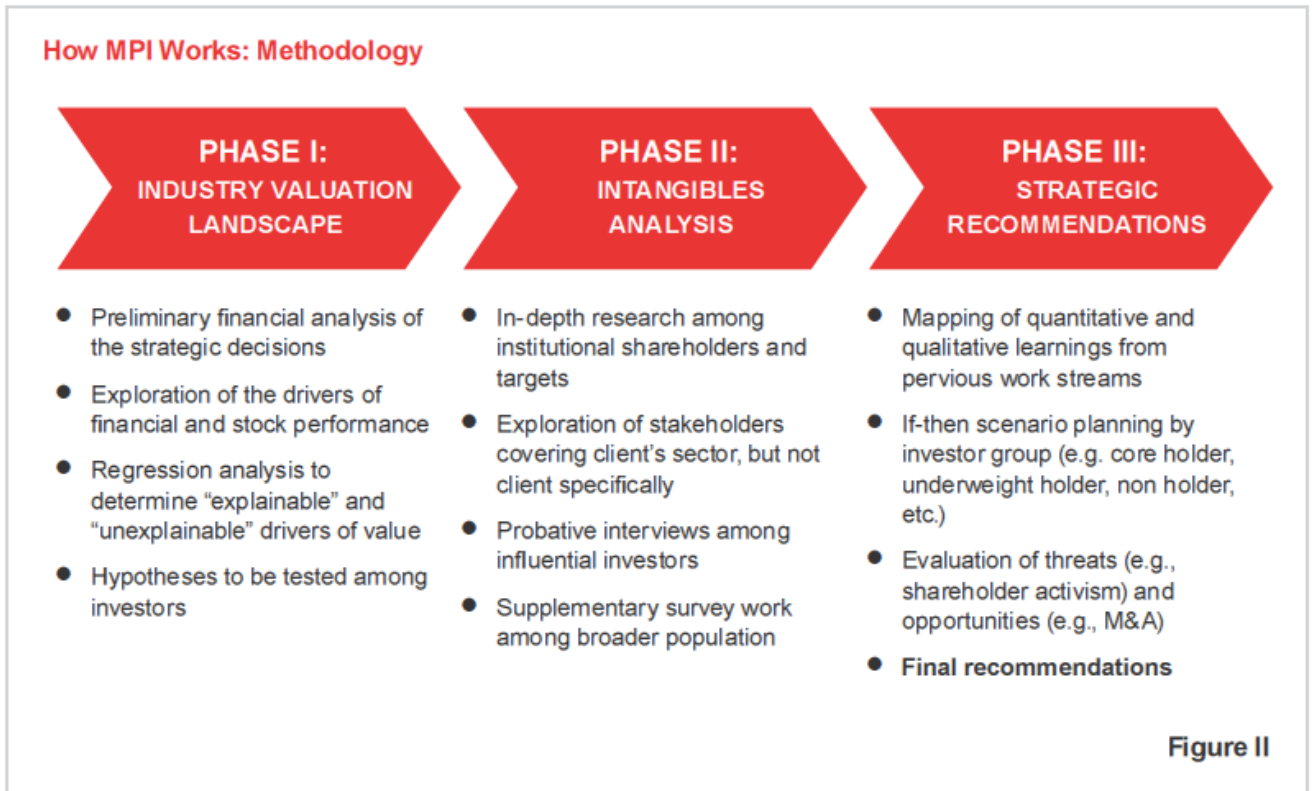
FTI Consulting developed the MPI as a strategic framework to help companies better understand the valuation complex and, in turn, inform more effective strategy and communications. Specifically, the MPI:

- Helps determine which parameters of performance have the most influence on valuation within an and prevailing market environment; and
- Quantifies and compares perceptions of a company relative to industry peers to determine the intangible factors that cause undervaluation and overvaluation.

The findings go beyond a collection of anecdotal information often found in typical "perception studies" empirical fact base. The resulting insights enable a company to structure a plan in which the strategy, goals and performance discussions are aligned with the dynamics that impact valuation, and that addresses perception gaps that are critical to close.

The MPI is especially valuable in dynamic situations where the industry environment or business model rapidly evolving or likely to change, and where there is substantial risk that a misunderstanding of value or a perception gap might impact enterprise value. Examples of such situations include changes in:

- Shareholder composition (e.g., shareholder activism)
- Growth strategies (e.g., organic growth vs. mergers and acquisitions)
- Strategy or business model
- Executive leadership
- Competitive landscape or regulatory
- Macroeconomic environment



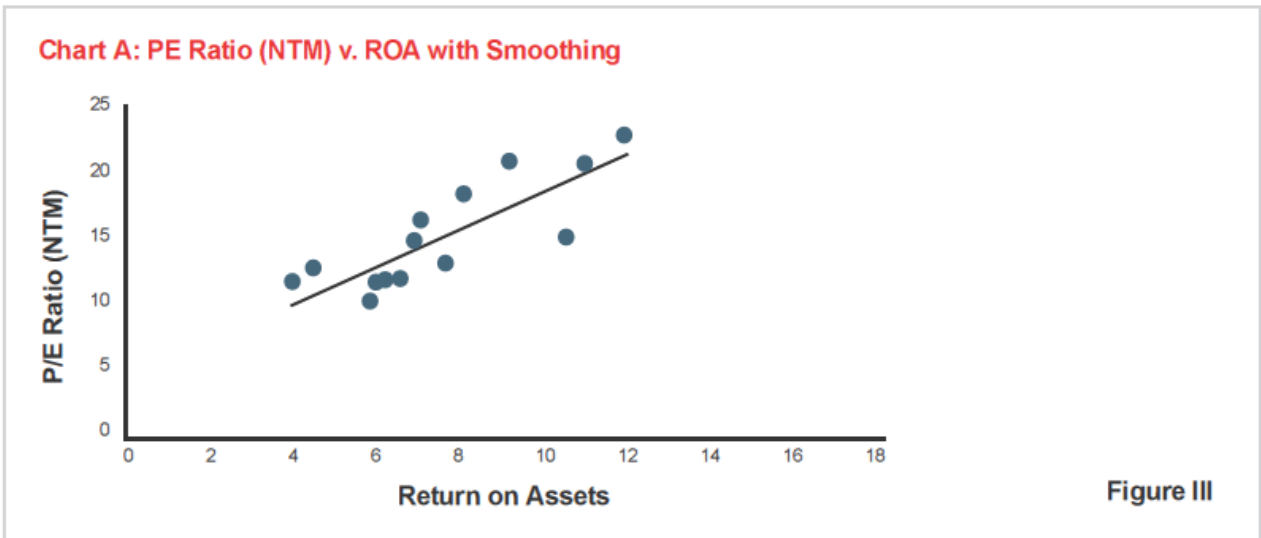
Phase 1: Creating the Industry Valuation Landscape

The initial phase of the MPI is to understand which dimensions of operating performance are being rewarded by the market.

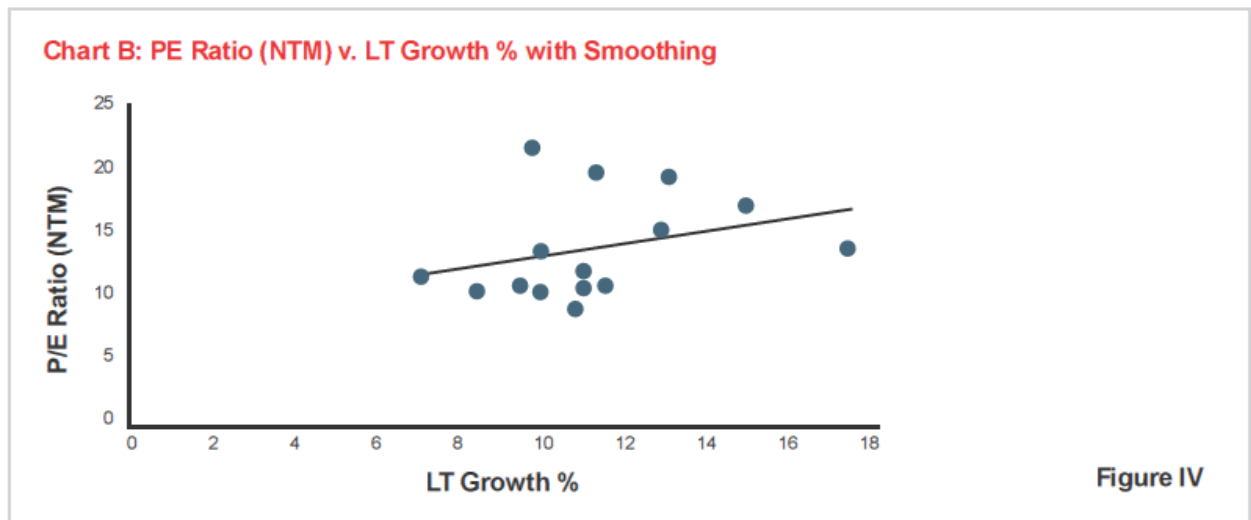
FTI Consulting first performs a financial analysis of the company's financial and operating performance compared to a selected peer group of similar firms across a range of discrete KPIs. representative KPIs often used are measures of asset and capital efficiency, profitability, growth (sales, earnings and assets), and financial strength, among others. Performance metrics are not uniformly important in all industries, so the analysis is tailored to what is most relevant for any given industry, peer set and company in question.

Insights delivered in the above analysis are then used to construct a multivariate view of the company's industry that relates those performance measures to relevant valuation methodologies to find which are most highly correlated. This generates a regression analysis for each performance measure, as shown in the charts below, of how the market is valuing industry participants across the performance continuum.

As illustrated in Figure III below, from an actual case study, the relationship between valuation and return on assets is high (data points are clustered close to the regression line) and strongly positive (slope of the regression line is up and to the right).



As can be seen in Figure IV below, the valuation relative to expected long-term growth is not nearly as positive or strongly correlated as it is with ROA.



This analysis would be conducted across all the relevant KPIs, which upon completion, provides several valuable observations: 1) an objective, unvarnished perspective on how the company fundamentally performs against a peer group; 2) the valuation structure of the industry and whether a company is overvalued, fairly valued or undervalued compared to the industry norm for its given level of performance; and 3) which performance parameters are most important in determining the valuation structure of the industry.

Knowing the measures of performance that are being rewarded by the market enables a company to frame its discussion of strategy, goals, performance and its investment proposition in terms that can have the highest degree of impact on valuation. going back to the simple two-variable example above, if capital efficiency (roa) is highly correlated to valuation, and growth is not, an announcement of an acquisition that touts growth, scale and earnings accretiveness may disappoint investors if the acquired business is poorly managed and dilutes the pro-forma roa, and if management fails to satisfactorily articulate plans and objectives for improving the target's capital efficiency.

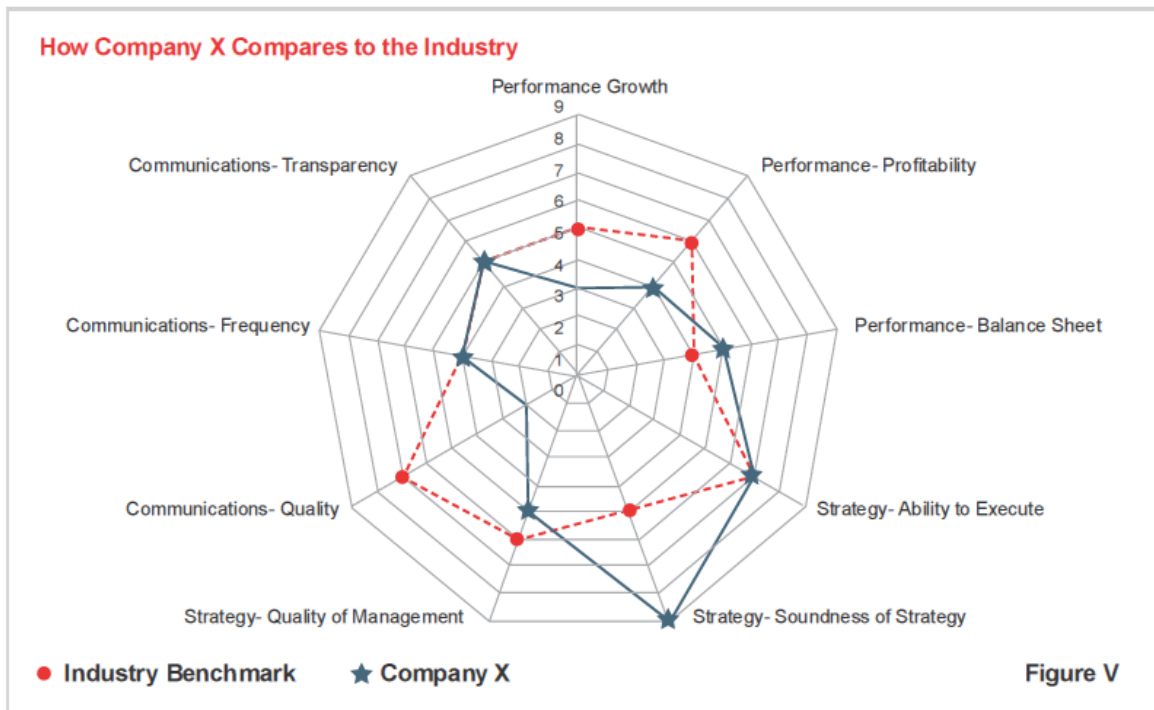
Phase 2: Analysis of Intangibles Driving Valuation

Valuation anomalies that are not accounted for by performance are the result of intangibles and the products of perception. If a company is outperforming its peers but undervalued, it is likely because investors do not adequately understand the company's performance, do not believe the performance is sustainable, do not trust the company's communications or are generally confused by some combination thereof.

The second phase of the MPI, therefore, extends the learnings from the financial analysis in the first phase into the domain of intangible valuation drivers through a comprehensive analysis of perceptions. The framework of Phase 2 is built around three overarching dynamics that have a meaningful impact on valuation:

- **Performance:** While Phase I of the MPI assesses how the market has rewarded operating performance on a historical basis, Phase II offers a forward-looking perspective into the KPIs that are expected to have the highest degree of impact on future valuation. In addition, it captures how investors assess a company's assets, market position and confidence in management's ability to generate returns to shareholders compared to peer companies.
- **Strategy:** Since the market is a discounting mechanism, investors must have visibility into where a company is going and what it will look like when it gets there. The viability of a company's strategy for exploiting competitive advantages and negotiating the industry environment determine investors' confidence and the extent to which they discount future operating performance.
- **Communications:** the most well-crafted strategy and flawless execution can remain "best-kept secrets" if a company does not properly communicate its business and investment proposition, and earn investor buy-in. This includes an assessment of the key communicators of the company as well.

The MPI measures and quantifies investor perceptions of a company against its peer group across the dimensions described above. This provides management with a definitive view of its performance profile, and identifies where it exceeds and lags the industry, as shown in the representative chart below.



Phase 3: Strategic Recommendations

The final phase of the MPI brings together the first two phases of research in a comprehensive report and analysis of key findings. This includes a mapping of quantitative and qualitative learnings, additional secondary analyses that support the initial research hypotheses, and an action plan on how to leverage the findings and implement the recommendations.

The final outcome will inform and guide a company's strategy and communications. Learnings from the MPI ensure that the business and investment positioning are aligned with what the market is valuing in the current investment climate, and address any knowledge and credibility gaps that are preventing a company from being accorded a proper valuation.

Apart from the core positioning platform, recommendations from the MPI also include the optimal communications channels and forums, and insights into practical steps that can be taken to improve the effectiveness of a company's investor relations and corporate communications functions.

Applications to Developing Strategy

It is important to note that while the above discussion is dedicated to optimizing communications to the financial community, the MPI can and, in many instances, should be extended to other constituencies such as employees, customers or business referrers, elite audiences, and any other stakeholder group that impacts the value creation of a company. This work informs corporate strategy by advising on the potential value creation of strategic alternatives and anticipating market reaction to specific initiatives, and by gaining an understanding of how a strategic decision will be received by constituencies that must buy into it. This provides an opportunity to anticipate pushback and revise the strategy if necessary before management's credibility is invested in it.

Conclusion

The market is constantly evaluating each and every company, their peers and their industry, challenging leadership to continuously manage and protect the company's enterprise value. Knowing what measures of performance are being rewarded by the market and which intangibles have the highest degree of influence on valuation are critical to designing and executing business strategies and communications that yield optimal valuations. While performance matters, perceptions are even more important since the market is focused on what the company is going to do, not what it has done. For this reason, suboptimal valuations are often due to gaps between internal and external perceptions and expectations.

The MPI is an innovative strategic framework designed specifically to address these issues, and it can be especially valuable in dynamic situations where the industry environment or business model is rapidly evolving or likely to change. It also works well in steady states as a planning tool in advance of known and unforeseen special situations, as well as a benchmarking analysis to gauge the impact of changes in communication (or perception), strategy and performance on valuation over time.

Please contact us if you are interested in learning more about the FTI Consulting MPI and how it can help protect and enhance your enterprise value.



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ABOUT FTI CONSULTING

FTI Consulting, Inc. is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 3,700 employees located in 22 countries, FTI Consulting professionals work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring. The company generated \$1.4 billion in revenues during fiscal year 2010. More information can be found at www.fticonsulting.com.

ABOUT THE STRATEGIC COMMUNICATIONS PRACTICE

The Strategic Communications practice of FTI Consulting, formerly known as FD, is one of the world's most highly regarded communications consultancies. With more than 20 years of experience advising management teams in critical situations, the Strategic Communications practice supports clients in protecting and enhancing their reputation in the capital markets, society and the political environment. Services of the Strategic Communications practice are financial communications, corporate communications and public affairs, with specialty offerings that include strategy consulting, research, creative engagement, crisis and issues management, and change communications. The Strategic Communications practice of FTI Consulting is an established market leader in M&A communications and has been for many years.