AMERICA'S MOST SHAREHOLDER FRIENDLY COMPANIES

Institutional Investor

Friendly Persuasion

In a time of heightened investor activism, corporate executives are stepping up their efforts to improve their appeal to shareholders. Here are the companies winning investors' hearts, minds — and money.

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RUNNING A PUBLIC COMPANY in today's hypercritical, overly scrutinized environment is no easy task. Chief executives and their management teams not only must keep their eyes on day-to-day operations, but they also have to devote increasing amounts of time and energy to ensuring that investors are satisfied with the direction in which companies are going and the financial decisions being made. These days, shareholders insist on being well informed, and few will refrain from protesting if they aren't happy. Many have become more demanding — and vocal — about their expectations.

"If you try to hide information, you lose credibility and make yourself a target for activist investors," observes Alice Lehman, head of investor relations at Charlotte, North Carolina–based Wachovia Corp.

Home Depot found that out the hard way. Shareholders cheered the arrival of Robert Nardelli as chief executive officer when he took the helm of the Atlanta-based retailer in 2000. They cheered again when he was booted in January. Investors had become enraged to learn that, since taking the top job, Nardelli had earned more than $240 million while the company's shares were losing value. They wanted answers. Nardelli's standoffishness — he famously refused to answer questions at last May's annual meeting — only inflamed matters, leading to a shareholder uprising.

Nor was his defenestration unique. Investors angry over Henry McKinnell Jr.'s $200 million pension forced the resignation of the Pfizer CEO last July, and UnitedHealth Group CEO William McGuire earned the wrath of shareholders — and the scrutiny of the Securities and Exchange Commission — when it was revealed that his backdated stock options totaled $1.6 billion; McGuire left the company in November.

"There is a shorter fuse on the whole notion of bad corporate governance practices," sums up Kurt Schacht, managing director of the CFA Centre for Financial Market Integrity in New York. "Rational investors want a company to have the right practices in place and be accountable."

Shareholders have all the time in the world — and no end of admiration — for executives at U.S. companies that treat them well. This year, for the second time, we asked investors to name the companies that they considered the most responsive to shareholders. Altogether, more than 760 portfolio managers and investment analysts from some 400 companies, with combined assets under management of $6.3 trillion in U.S. stocks, gave us their evaluations of companies in their areas of expertise; the winners constitute *Institutional Investor*'s second-annual ranking of America's Most Shareholder-Friendly Companies. The top-rated companies in 62 sectors appear in the table on page 51; the complete ranking can be found on our Web site, www.institutionalinvestor.com.

The results are eye-catching. Some of the companies, such as Walt Disney Co., General Electric Co. and Johnson & Johnson, are household names; others are less well known to consumers — steel manufacturer Nucor Corp., recycling and waste management services provider Republic Services, electronics manufacturer Jabil Circuit — but have made themselves favorably known to investors. And in interviews with *II*, shareholders are clear about what they want: detailed, easy-to-understand financial information; proof of good governance; access to company officers; and a clear justification of executive compensation.

Failure to meet these expectations can land a company in the headlines and in the doghouse with the investment community, as investors make clear in this year's survey. In last year's inaugural survey, Home Depot was the top-ranked Retailing/Hardlines company. By the time shareholders began to participate in this year's survey, they were already restless; the company falls to fourth place in voting that concluded in midsummer — months before Nardelli received his comeuppance. Pfizer, ranked third last year in Pharmaceuticals/Major, fails to rank this year; and UnitedHealth Group, last year's No. 1 Managed Care company, slips to second place.

Shareholder uneasiness has not been lost on corporate chieftains, many of whom are reaching out to investors as never before. JoAnn Reed, chief financial officer of Medco Health Solutions, says she has stepped up her efforts to meet with shareholders. "We like to do as many investor conferences as possible to get our message out and continue to get exposure in the marketplace," says Reed, adding that roughly 25 percent of her time is spent at such conferences, up from 15 percent a few years ago.

Reed also makes sure that earnings reports hold no surprises for shareholders. Medco's investor relations team sends an advance e-mail blast to investors with "very detailed information around the results," Reed says, and follows up by phone with the company's biggest investors to answer any questions. "The more information we give out to shareholders, as well as the analyst community, the better off we are," she says. "When analysts are better able to manage their financial expectations of the company, they get better data out to our shareholders."

Investors approve of Medco's outreach efforts: This year the Franklin Lakes, New Jersey–based outfit is rated the most shareholder-friendly among Health Care Technology & Distribution companies, up from second place last year. "They're very responsive and quick on every question I've asked them," says Joshua Fisher, health care equities analyst at Pequot Capital Management in New York. "A lot of companies, when they get to be large-cap, don't give you good answers. Medco makes sure to give you answers — the CEO, CFO, investor relations, the whole management team."

The management team at Wachovia also makes a point of giving shareholders the answers they want, even as it engages in the kind of aggressive expansion that can give investors fits. "We've done four or five major acquisitions, and we always get a negative reaction," says CEO G. Kennedy Thompson, referring to Wachovia's acquisitions of SouthTrust Corp. in November 2004, Westcorp and WFS Financial last March and Golden West Financial Corp. last October. "Every time we announce a deal, we are very clear about the things we need to do to make that deal successful."

As head of investor relations, Lehman set up what she calls a one-stop shop for shareholders — and potential investors — where they can find clear, accurate information. "The key is to not overwhelm shareholders with data but to help them understand how the company is doing and what its prospects are," she says.

Wachovia, rated most shareholder-friendly in the Banks/Large-Cap sector (up from second place last year), has added an Outlook section to its quarterly earnings release, to give investors insight into the company's financial goals and the ability to measure its progress. Managers' goals are outlined, and if a goal is not met, the manager must explain why — in writing. The point, Thompson says, is to build up shareholders' trust in the company and their faith that management will do what it says it is going to do: "We want them to be comfortable with the management team and our credibility."

Outlook is a hit with investors. "The disclosure in their financial statements is bar none the best," says one shareholder. "If you're an owner of Wachovia, shame on you if you don't know enough about the business, because they give you every opportunity."

When a company falls on tough times and investors are angry, management has two choices: stonewall shareholders à la Home Depot, or tell them everything they want to know. When J.C. Penney Co. hit the skids a few years ago, it opted for the latter approach, even though much of what company management had to tell investors wasn't good.

The Plano, Texas–based retailer saw its debt downgraded to below investment grade in 2000, after its share price fell below $10; its return on equity fell to 8 percent (from 20 percent in the mid-1990s); and its earnings before interest, taxes, depreciation and amortization dropped to 3 percent (from 9 percent in the mid-'90s). Robert Johnson, vice president and director of investor relations for the past six years, says that as part of its effort to turn the company around, management stepped up its participation in investor conferences, increased the number of conversations it had with analysts and established more regular contact with the Street. "You have to be visible," Johnson says. "Not every story was a good story, but generally, we've been on an upward trend."

The company embarked on a major restructuring, centralizing its buying process, selling its Eckerd Drugstores division in 2004 for $4.5 billion and repositioning itself as a trendy value retailer. Those initiatives showed signs of success in just a few years, with operating income rising from $253 million in 2003 to $977 million in 2006. J.C. Penney shares now trade in the mid-$80s, its ROE is above 30 percent, ebitda is at 11 percent, and the company is viewed as the most shareholder-friendly among Retailing/Broadlines & Department Stores.

"J.C. Penney is the most remarkable turnaround I've seen, from both a financing standpoint and an operational standpoint," says one shareholder. Company executives have "maintained a prudent capital structure throughout, which has given them time and enabled them to improve operations and to finally start growing again. Those things have created tremendous value."

Although the retailer's worst days appear to be in the past, J.C. Penney's management maintains its commitment to full disclosure and open communication with shareholders. "We're not biased on who we speak with," says Edward Merritt, manager of investor relations. "A lot of IR teams don't want to talk to a certain type of investor, but we treat everyone as if they're a potential investor."

In addition, J.C. Penney's annual reports include information that many corporations' don't, such as return on capital invested and return on capital employed, all in an effort to reassure shareholders that they have invested wisely.

Executives who succeed in meeting or exceeding shareholders' expectations will find themselves rewarded with investor loyalty. Those who don't may find their transgressions splashed across the front pages of the morning papers — and the subject of scrutiny on Capitol Hill.

Our America's Most Shareholder-Friendly Companies ranking was compiled by Associate Editor Michele Bickford under the guidance of Assistant Managing Editors Sathya Rajavelu and Tom Johnson and Senior Editor Jane B. Kenney.

Picking the Winners

More than 760 analysts and portfolio managers at some 400 money management firms responsible for investing a combined $6.3 trillion in U.S. stocks participated in selecting Institutional Investor's 2007 list of America's Most Shareholder-Friendly Companies. These asset management professionals were asked to name the companies they consider the most shareholder-friendly in the industry sector (or sectors) for which they are responsible. In making their choices, voters were instructed to consider the effectiveness of companies' governance and investor relations as part of their overall efforts to maximize shareholder value. Respondents gave their first, second, third and fourth choices, which we weighted to produce a score for each company. We name the most shareholder-friendly companies in each of the 62 industry sectors surveyed for the 2006 All-America Research Team.

The Top Shareholder-Friendly Companies of 2007

Listed here by sector and industry are the companies that scored the highest when we asked portfolio managers and sell-side equity analysts to choose the most shareholder-friendly companies in their domains.

BASIC MATERIALS	
Chemicals/Commodity	Monsanto Co.
Chemicals/Specialty	Praxair
Metals & Mining	Nucor Corp.
Paper & Forest Products	International Paper Co.
CAPITAL GOODS/INDUSTRIALS	
Aerospace & Defense Electronics	United Technologies Corp.
Airfreight & Surface Transportation	United Parcel Service
Business & Professional Services	Manpower
Electrical Equipment & Multi-Industry	General Electric Co.
Environmental Services	Republic Services
Machinery	Illinois Tool Works
Packaging	Ball Corp.
CONSUMER	
Airlines	Southwest Airlines Co.
Apparel, Footwear & Textiles	Coach
Autos & Auto Parts	Johnson Controls
Beverages	PepsiCo
Cosmetics, Household & Personal Care Products	Procter & Gamble Co.
Food	Hershey Co.
Gaming & Lodging	Harrah's Entertainment[1]
Homebuilders & Building Products	D.R. Horton
Leisure	Carnival Corp.
Restaurants	Yum! Brands
Retailing/Broadlines & Department Stores	J.C. Penney Co.
Retailing/Food & Drug Chains	CVS Corp.
Retailing/Hardlines	Staples
Retailing/Specialty Stores	Chico's FAS
Tobacco	Altria Group
ENERGY	
Electric Utilities	TXU Corp.
Integrated Oil	Exxon Mobil Corp.
Natural Gas	Questar Corp.
Oil & Gas Exploration & Production	EOG Resources
Oil Services & Equipment	Schlumberger
FINANCIAL INSTITUTIONS	
Banks/Large-Cap	Wachovia Corp.
Banks/Midcap	Zions Bancorp.
Brokers & Asset Managers	Lehman Brothers Holdings
Insurance/Life	Aflac
Insurance/Nonlife	Allstate Corp.
Mortgage Finance	Countrywide Financial Corp.
REITs	Host Hotels & Resorts Inc.
Specialty Finance	Capital One Financial Corp.
HEALTH CARE	
Biotechnology	Gilead Sciences
Health Care Facilities	Community Health Systems
Health Care Technology & Distribution	Medco Health Solutions
Managed Care	WellPoint
Medical Supplies & Devices	Johnson & Johnson
Pharmaceuticals/Major	Eli Lilly and Co.
Pharmaceuticals/Specialty	Barr Pharmaceuticals
MEDIA	
Cable & Satellite	Comcast Corp.
Entertainment	Walt Disney Co.
Publishing & Advertising Agencies	Gannett Co.; E.W. Scripps Co.
Radio & TV Broadcasting	Clear Channel Communications[2]
TECHNOLOGY	
Computer Services & IT Consulting	Accenture[3]
Electronics Manufacturing Services	Jabil Circuit
Imaging Technology	Adobe Systems
Internet	Yahoo!
IT Hardware	Hewlett-Packard Co.
Semiconductor Capital Equipment	KLA-Tencor Corp.
Semiconductors	Texas Instruments
Software	Microsoft Corp.
TELECOMMUNICATIONS	
Data Networking & Wireline Equipment	Cisco Systems
Telecom Equipment/Wireless	Qualcomm
Telecom Services/Wireless	Alltel Corp.
Telecom Services/Wireline	AT&T

1 Accepted a private equity buyout bid in December 2006. 2 Agreed on November 16, 2006, to be taken private. 3 Based in Bermuda.