

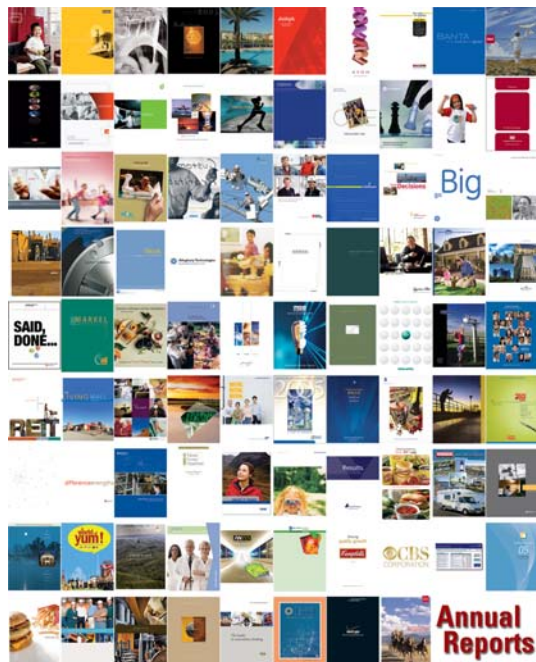
Look for Candid Messages

Beyond the Glossy Paper

by Jo Napolitano

Warren Buffett has been sprinkling his annual shareholder letters with folksy humor for years, always adding his personal touch.

In a February 2006 letter he wrote about the future of Berkshire Hathaway after his death or mental decline. He ended the discussion with a spark of levity: “And while we’re on the subject, I feel terrific.”



Many find Buffett’s letters entertaining and important commentaries on the state of investing and business. Beyond learning the basics about a company’s markets, facilities and other general information — all of which is important to investors studying a stock — there’s little consensus on how useful annual reports are. That’s because there are two schools of thought on them. While some investing experts say they’re crucial to understand-

ing a company’s future, others believe they’re too craftily worded and self-congratulatory to mean much of anything.

To a novice investor, an annual report can feel like a maze, a complicated missive interrupted by numbers with no context. This can make it a chore to read, even for experts.

How You Say It Counts

Laura Rittenhouse, president of andBEYOND Communications based in New York, has spent years pour-

ing over these documents. She says there’s a direct correlation between honest shareholder letters and stock price performance.

“It’s very hard to judge candor, but it’s easy to judge lack of candor,” she says.

Rittenhouse believes there are red flags that could signal a company isn’t being forthcoming. Some try to dance around the truth by using empty phrases like “solid results” in describing their financial performance, but they don’t back up their statements with any hard data, she says.

“You can see there’s an effort to try and mislead,” Rittenhouse says. “Sometimes, often in a letter, you can see a contradiction.”

Others use clichés, saying they have a “bright future,” or they create confusion by omission, leaving out important and relevant information. And some use hyperbole to try to bolster performance.

A cosmetics company, for example, might say its product delivered the targeted results, Rittenhouse says. “What is that? To clear up acne?”

In stressing to shareowners the importance of trust, another company might refer to trust as a commodity. But commodities can be bought and sold, Rittenhouse says.

Each year Rittenhouse ranks the best and worst shareholder letters. At the top of this year’s list, released

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in early May, were Wells Fargo, Alcoa, JetBlue, PepsiCo, Walgreen Co., Jack in the Box, Continental Airlines, Charles Schwab, Harley-Davidson and Xerox.

CEOs who use annual reports to speak candidly with investors tend to have greater stability in their communication year after year, she says, touching on the same topics as a way of updating investors. "They're giving you relevant, meaningful information."

Besides, the so-called hard numbers are hardly scientific. Just ask the folks who sunk their money into Enron.

"You can look at the numbers, but where do they come from?" Rittenhouse says. "They're simply accounting figures, the results of numerous judgments made from people inside the company."

The figures can be conservative or aggressive; they can be truthful or they can obscure the truth. But a high degree of candor signifies a coherent corporate culture, Rittenhouse says, making her more likely to trust the numbers.

Effects of SOX

Some investing experts blame the Sarbanes-Oxley Act — established in the wake of the accounting scandals of the late 1990s and early 2000s — for the death of the candid annual report. Companies are too scared to be colorful, they say. Instead, some corporations have opted for a more lifeless and roundabout way to communicate to reduce their legal exposure if something goes bust.

Many investing experts say they've turned to other means to learn about a company. Hulus Alpay, senior vice president and head of investor relations at Makovsky & Co., a New York-based investor rela-

tions and public relations firm, cited websites operated by The Motley Fool and TheStreet.com.

Investors shouldn't put too much stock in annual reports, Alpay says. But he also recognizes the significance of an honest shareholder letter as a way to help determine a company's success. Good annual reports speak frankly about strategy, direction and vision. Forget the past, he says. A good company will have already communicated its previous successes and failures. Annual reports should be about the future.

Alpay mentions the Peter Lynch strategy of investing in what you know as a way for investors to find good companies instead of going through annual reports. For example, he made investments in discount chains after he realized he did a lot of shopping at these stores.

George Tsiolis, president of AGORA Investor Relations in Canada, says many people have turned away from annual reports and instead rely on websites such as Yahoo! Finance to get the latest information on companies. These types of sites have a great amount of free information.

Google just launched its own finance portal, but Tsiolis believes it's too soon to judge its usefulness. Still, the new site does have one clear advantage, he says, in that it links to blogs that have recently mentioned a specific company.

"It tells you what your peers have to say," he says. "There are some savvy people out there. Google has a winning combination with that."

Tsiolis believes it's too confusing for investors to try to find their own data, or, in some cases, to decipher what they get from the companies themselves. Yahoo! Finance and other sites can help investors get an idea about what the experts are say-

ing about the health of these companies without the hidden nuances of annual reports.

"There was a day when (annual reports) were more frank, colorful and friendly," he says. "Now they're more convoluted."

Relying on Legwork

Ray DeVoe, author of the *DeVoe Report*, a highly respected investor newsletter, gets his information the old-fashioned way: He calls people and asks their opinions. It's a low-tech method, but it seems to work for him. "I get my information from all over," he says.

If DeVoe wants to learn more about a particular company, he'll ask its competitors. And he likes to see things for himself, so he'll go out to Target and Best Buy, for example, and simply look at what people are buying.

Jeff Ryan, senior equity researcher at Charles Schwab, doesn't place all of his trust in any one source. As for annual reports, Ryan skips to the financial footnotes to try to gauge a company's stability.

Rein Nomm of Plymouth, Mich.-based investor relations group Rein Nomm & Associates, Inc., says he gives annual reports a cursory review. He spends much more time looking at the income and loss statement and the balance sheet. **B**

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