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## **The Birth of “Video Annual Reports:” A Substitute for the Written Word?**

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For a variety of reasons, some companies have experimented with a “video annual report” over the past few years. Past innovators include Kenneth Cole, California Pizza Kitchen, Sealy, Jo-Ann Stores, Equity Inns, Cognex, Pike Electric, River Rock Entertainment Authority, Education Realty Trust and Ruth’s Chris Steak House. These companies are building on the experiences of innovators who have used video as part of their written online annual reports in the past (e.g., IBM, GE, Nike, Shell and Phillips).

The emergence of this new form of annual report may further accelerate the convergence of corporate communications and investor relations—as well as help companies cover the bases with its shareholders by using multiple forms of media to communicate with investors.

### **Reasons to Try a Video Annual Report**

There are two primary reasons why companies are beginning to try video annual reports; one sound reason, one not so sound:

**1. Create a More Effective Shareholder Experience**—Video can be much more palatable to certain types of investors—typically retail investors—compared to the written word. From the company’s perspective, video can help better brand the company to investors. Companies can show off their management team, their products and services and other key assets or initiatives. A well-produced video can create a much more effective impression—and better capture a company’s strategy and mission—than a brochure-like glossy annual report. Studies show that humans retain 60% of what they see and hear. Learning by watching a video simply is a more compelling experience for investors compared to reading.

We have all known anecdotally that most shareholders throw proxy materials in the trash without bothering to open the envelope. Based on first-year e-proxy statistics from Broadridge, we now have the chilling statistic that only 0.4% of beneficial owners visiting Broadridge’s voting page bothered to click on the link entitled “Read Materials.”<sup>1</sup> Clearly, few retail investors are motivated to learn by reading about the company today. But the use of video may entice more shareholders to look at a written annual report. Video can be used to supplement written disclosure and bring investors to the important details disclosed in proxy materials.

As more investors are driven to IR web pages due to e-proxy and other factors, the inclusion of video on them is pure common sense. The explosive growth of You Tube—and online video in general—is well-documented. For many, watching video is a normal online experience today as a fast-increasing number of people have access to broadband Internet connections.

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<sup>1</sup> This statistic was derived by Broadridge based on a sampling of its clients. See Slide 5 of Broadridge’s presentation given to the SEC Staff on June 26, 2008 at <http://www.sec.gov/comments/s7-28-07/s72807-141.pdf>.

**2. Cost and Time Savings**—Most of the first movers that have experimented with video annual reports have done it as a way to save money and time (and because it does a better job in helping a company showcase and distribute management’s message and the company’s brand as noted in #1 above). These companies have relied on their videos to replace the traditional glossy annual report (*i.e.*, the content beyond the “Letter to Shareholders”) and thus reaped savings in printing and postage.

Video should be supplemental to a company’s key written disclosures, never a replacement. A “video-only” approach runs the serious risk of sending a message that the company isn’t serious about disclosure and is more interested in its own hype. So if a company is considering video annual reports solely for this reason, it should think again.

### **How to Create Effective Video Annual Reports**

Here are four factors to consider when determining whether to develop and post a video annual report:

**1. Create a “Straight Talk” Documentary**—One pitfall to avoid is making a video annual report that’s just a pitch for the company’s products and services. Don’t treat investors as not being capable of recognizing an infomercial. Yes, the video is a marketing tool—but treat investors as intelligent and give them as much straight talk as possible. A primary goal of the video should be to build trust, which will enhance the management’s team credibility.

The video should cover the bases from an investor’s perspective. Provide a sense of who the managers are and what their vision is, explain the key financial metrics and benchmarks for the past year and briefly describe the challenges and goals going forward. Avoid pure fluff so that investors take the remarks on the video seriously.

This is to say that the video should come across as not a “commercial” for a brand—but instead, it should be management laying down the tracks for the company and its strategy going forward.

**2. Produce Professionally; But Not an Infomercial**—Poorly made videos defeat the purpose of creating one in the first place. As a society that spends a lot of time in front of screens, we have become accustomed to polished and fast-moving video. But “polished” doesn’t mean “slick” or “hype” rather than professional. It shouldn’t look like an ad or it defeats the purpose for making the video; investors will recognize the video for what it is.

A professionally made video annual report will require a lot of editing, with some use of music and graphics in addition to talking heads. The average video annual report runs about four to six minutes and, in most cases, only takes about 45 minutes of management’s time to shoot their dialogue. The interviews can be done “documentary-style,” as opposed to a teleprompter approach.

Many companies now have in-house video capabilities and the corporate communications department might think they can produce the video annual report themselves. While that might be true, it likely would be tough for them to meet a 30-day production timeline—particularly because it’s a relatively new phenomenon—thus depriving the company of one of the key benefits of doing a video annual report. And the skill sets necessary to produce a video annual report often differs from those necessary to create a glossy annual report.

The cost of using a service provider typically falls near the lower end of the range of \$25,000 and \$50,000. The cost primarily depends on how many shooting sessions are required and how much time and travel is associated with these sessions. If a company already has pre-recorded video (*e.g.*, new product/service launch during the year; new key locations) that can be edited into the video

annual report, this will reduce the cost of using a service provider. Thanks to Tim Carey of ICR for his thoughts in this area.

**3. Don't Overlawyer It; But Do Lawyer It**—It should not be surprising that corporate lawyers have a natural dislike for video annual reports. They are trained that investor-oriented documents are liability-driven. The SEC's disclosure framework encourages companies to put them in the worst light possible to stave off lawsuits.

However, you don't want lawyering to diminish the purpose of the video annual report. You want viewers to feel good about the company. On the other hand, you obviously don't want materially misleading (or omitted) information to be included. This can be a delicate balance. Clearly, there should be no mention of the company's stock nor should there be bashing of competitors or any other puffery that draws the attention of the plaintiffs' bar or regulators. And don't forget to add a slide at the beginning of the video with the forward-looking safe harbor language (with a three-to-five second time frame), tailored to the forward-looking remarks made during the video.

Although the creation of storyboards might cause the typical 30-40 day timeframe to produce a video annual report, someone from Legal and other members of the company's Disclosure Committee should review an outline of the remarks to be made before a CEO's/CFO's time is wasted by needing to reshoot a troubling video segment. A reshoot also causes the cost of the production to sharply increase. And don't forget that the Disclosure Committee should review the final product before it's posted on the company's IR web page.<sup>2</sup>

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<sup>2</sup> Here are a few points worth noting about how the SEC's regulations impact video annual reports. First, the video annual report doesn't need to be "filed" with the SEC so long as the video doesn't include the types of content that are required to be filed.

Instruction G(2) of Form 10-K allows incorporation by reference of Part II information, much of which typically comes from the glossy annual report like the MD&A and selected financial data. However, this is not the type of information that can be easily conveyed by video—rather, the information used in a video would be of the type that wouldn't be incorporated into a 10-K. This is fortunate because—as the SEC's EDGAR cannot accommodate multimedia—a script or fair and accurate description of any multimedia used in a required SEC filing must be filed under Rule 304 of Regulation S-T. This can be time-consuming and a hassle to create.

In comparison, Rule 14a-3(c) requires companies to "furnish" seven copies of the report containing all the information required by Rule 14a-3 to the SEC no later than the day it is first provided to shareholders. "Furnish" means mail to the SEC's headquarters and not bother with "filing" in via Edgar. It's a grey area if companies are required to furnish their video annual reports under this rule. It likely depends on the video's contents—if it includes any of the information enumerated in Rule 14a-3, it may well need to be furnished. In that case, I imagine a company can download its video annual report to seven CD-ROMs and send them in (and a script would not need to be created under Rule 304 of Regulation S-T). Unfortunately, there is no established mechanism by which an e-mail can be sent to the SEC Staff with a link to the online video.

Second, for over a decade, the SEC has permitted companies to create multiple versions of the same legally required documents—such as a proxy statement—each with differing content (so long as each version meets the applicable legal requirements). In other words, companies can have an unlimited number of versions—and each version can have different text, graphics, audio or spreadsheets. The SEC's multiple version guidance is in Example 7 of Release 33-7288 (May 9, 1996).

This provides companies with a great deal of flexibility, but not many companies have taken advantage of this flexibility over the years—most likely due to the cost and resources involved in creating multiple versions (but also probably due to concerns about different content in different documents). So long as each document is reviewed and scrubbed by the lawyers, this concern can be overcome. One outdated part of the SEC's guidance is that each version is supposed to disclose that another version exists - but this does not mean that investors are entitled to get a copy of the other version.

**4. Don't Forget the Written Word**—Each of us learns better in different ways. Some of us prefer video, some prefer it in writing. When it comes to the annual report, I think it would be a mistake to solely rely on video. And when producing a written document, it's important to use "good" HTML and not the image-based or Flash documents that too many companies use today.

The "Letter to Shareholders" in the glossy annual report can be an important way to connect with investors, particularly if it's "straight talk" as so aptly demonstrated by Warren Buffett. Companies can produce video annual reports that squarely supplement the "Letter to Shareholders."<sup>3</sup> When doing so, it's important to ensure that the messages from the "Letter to Shareholders" are consistent with what's portrayed in the video annual report.

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<sup>3</sup> Both of these would be crucial pieces of the company's online campaign for its annual shareholders' meeting. See "The Coming Online IR Campaigns: The Future of Director Elections" from the Spring 2008 issue of InvestorRelationships.com. And said before, some of the cost savings should be spent on providing key SEC filings in dynamic HTML, including the Form 10-K wrap and proxy statement.