

IR Trends to Watch in 2021

February 5, 2021



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Agenda

1. **Corporate Purpose & Milton Friedman's Legacy** (Hal Weitzman, University of Chicago Booth School of Business)
2. **Market Valuation Overview, ESG & Capital Allocation Insights** (David Sekera, Morningstar)
3. **Inside the Buy-Side® Survey Findings and Keys to Capturing Investor Mindshare** (Rebecca Corbin, Corbin Advisors)
4. **Q&A** (Corbin, Sekera & Weitzman)



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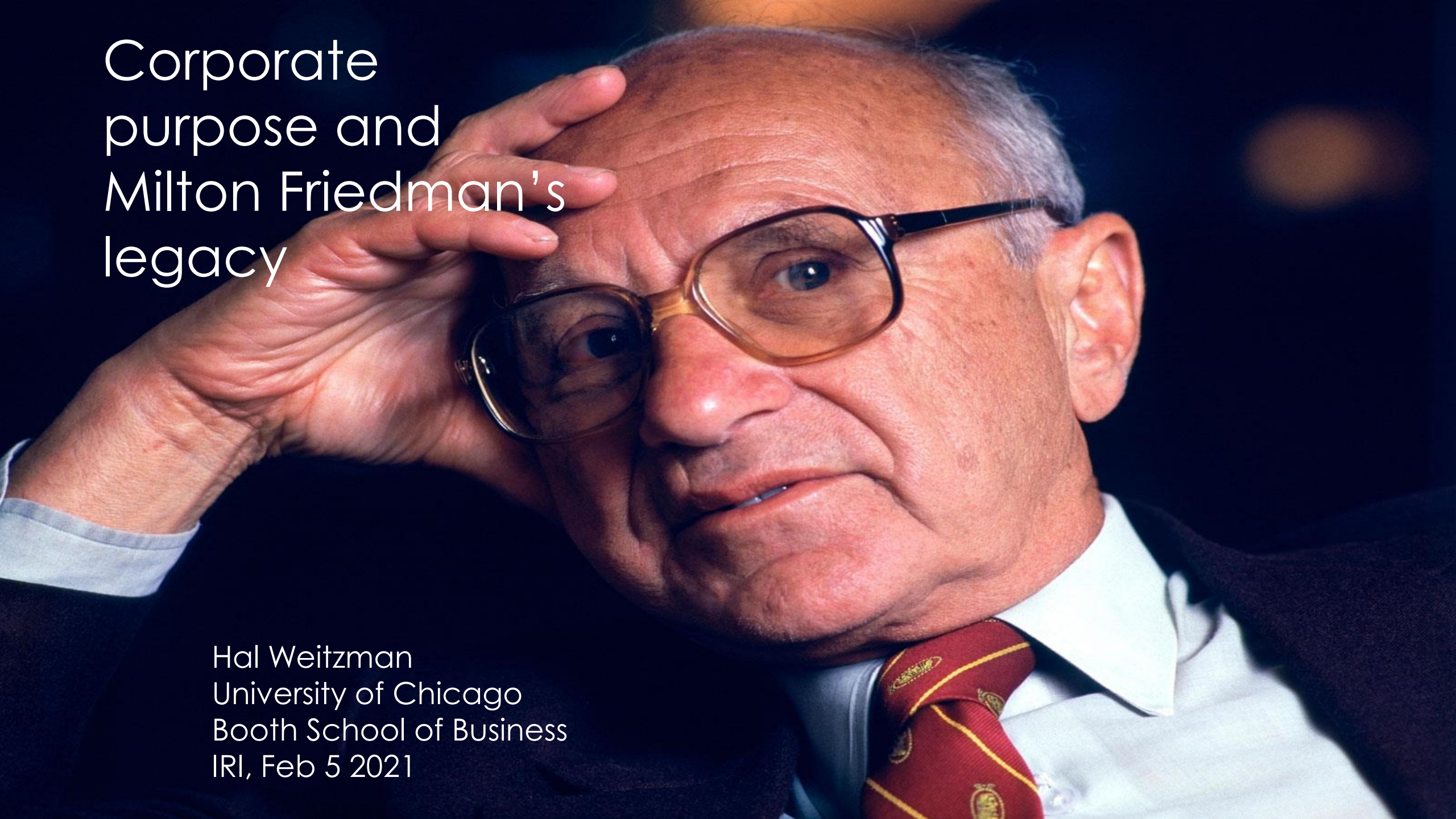
Corporate purpose and Milton Friedman's legacy



Hal Weitzman
University of Chicago
Booth School of Business
IRI, Feb 5 2021

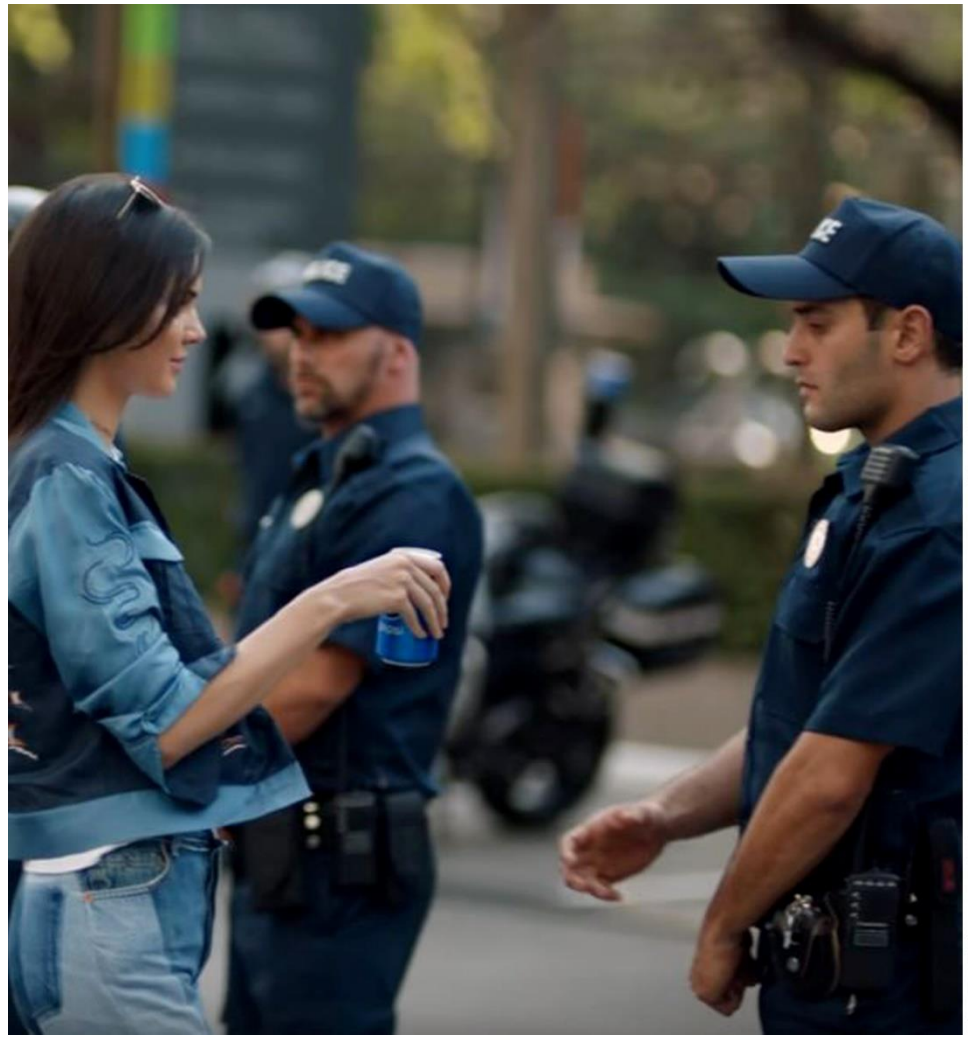














Be A King
@BerniceKing

If only Daddy would have known about the power of #Pepsi.



11:15 AM · Apr 5, 2017

262.8K 136.5K people are Tweeting about this

Pepsi
@pepsi

Replying to @BerniceKing

We at Pepsi believe in the legacy of Dr. King & meant absolutely no disrespect to him & others who fight for justice.

Pepsi was trying to project a global message of unity, peace and understanding. Clearly we missed the mark, and we apologize. We did not intend to make light of any serious issue. We are removing the content and halting any further rollout. We also apologize for putting Kendall Jenner in this position.

2:52 PM · Apr 5, 2017

2.3K 1.3K people are Tweeting about this

COMMENTARY • DIVERSITY AND INCLUSION

PepsiCo CEO: 'Black Lives Matter, to our company and to me.' What the food and beverage giant will do next

BY **RAMON LAGUARTA**

June 16, 2020 2:00 PM CDT



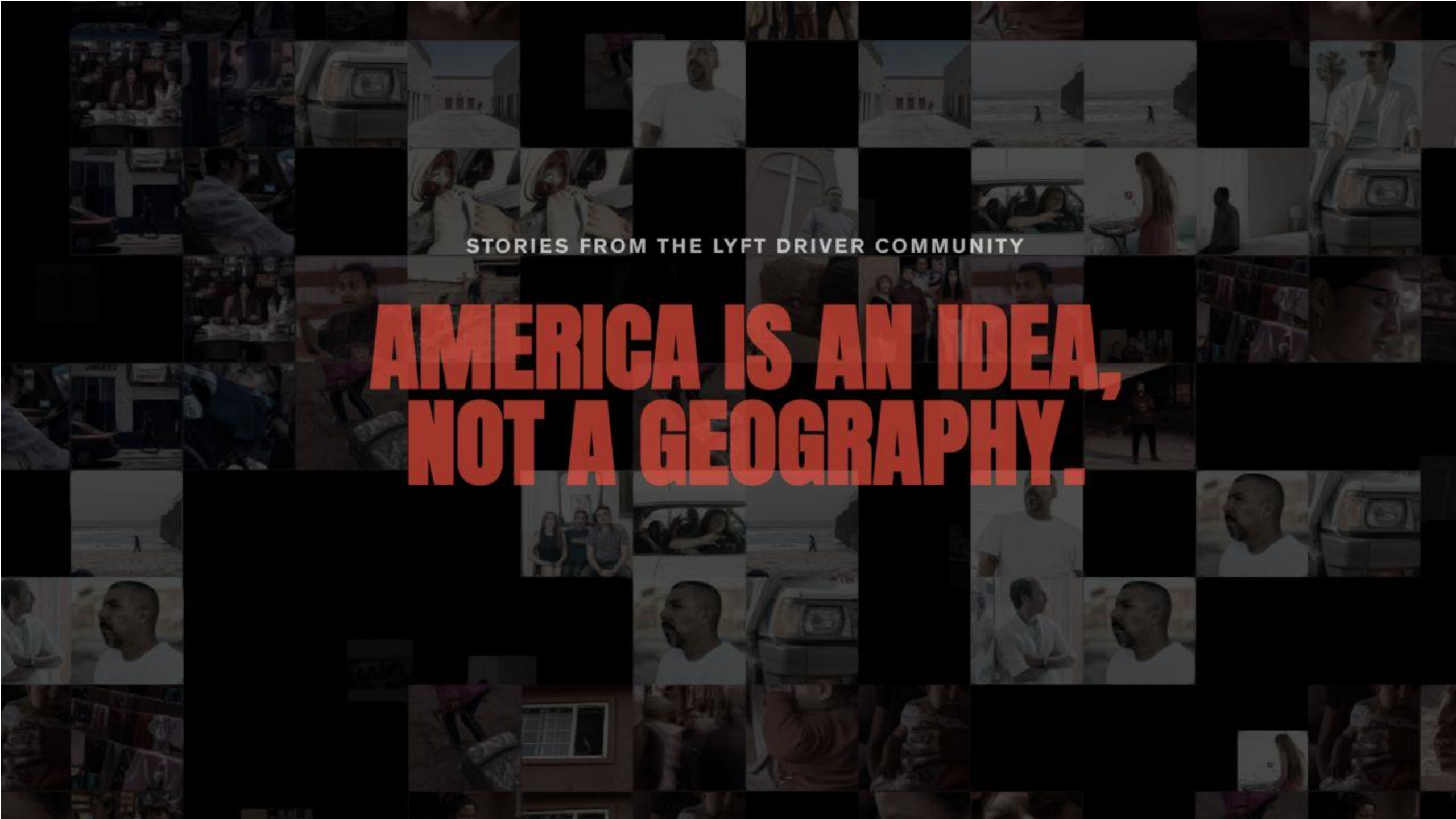
PepsiCo CEO Ramon Laguarta at the World Economic Forum's annual meeting in 2019.

FABRICE COFFRINI—AFP VIA GETTY IMAGES


Believe in something.
Even if it means sacrificing everything.
Just do it.


introducing THE PROUD
WHOPPER


introducing THE PROUD
WHOPPER
WE
ARE
ALL
THE
SAME
INSIDE


STORIES FROM THE LYFT DRIVER COMMUNITY
AMERICA IS AN IDEA,
NOT A GEOGRAPHY.

BEN & JERRY'S

BLACK LIVES MATTER

WE MUST DISMANTLE WHITE SUPREMACY



TOMS

Nasdaq to Advance Diversity through New Proposed Listing Requirements

PUBLISHED

DEC 1, 2020 7:15AM EST

NEW YORK, Dec. 01, 2020 (GLOBE NEWSWIRE) -- Nasdaq (Nasdaq: NDAQ) today filed a proposal with the U.S. Securities and Exchange Commission (SEC) to adopt new listing rules related to board diversity and disclosure. If approved by the SEC, the new listing rules would require all companies listed on Nasdaq's U.S. exchange to publicly disclose consistent, transparent diversity statistics regarding their board of directors. Additionally, the rules would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority1 or LGBTQ+. Foreign companies and smaller reporting companies would have additional flexibility in satisfying this requirement with two female directors.



CORPORATE GOVERNANCE

Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'

AUG 19, 2019

Updated Statement Moves Away from Shareholder Primacy, Includes Commitment to All Stakeholders

WASHINGTON – Business Roundtable today announced the release of a new Statement on the Purpose of a Corporation signed by 181 CEOs who commit to lead their companies for the

"Since 1978, Business Roundtable has periodically issued Principles of Corporate Governance. Each version of the document issued since 1997 has endorsed principles of shareholder primacy – that corporations exist principally to serve shareholders. With today's announcement, the new Statement



"There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits."

Capitalism and Freedom, 1962

"The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends … In fact they are—or would be if they or any one else took them seriously—preaching pure and unadulterated socialism."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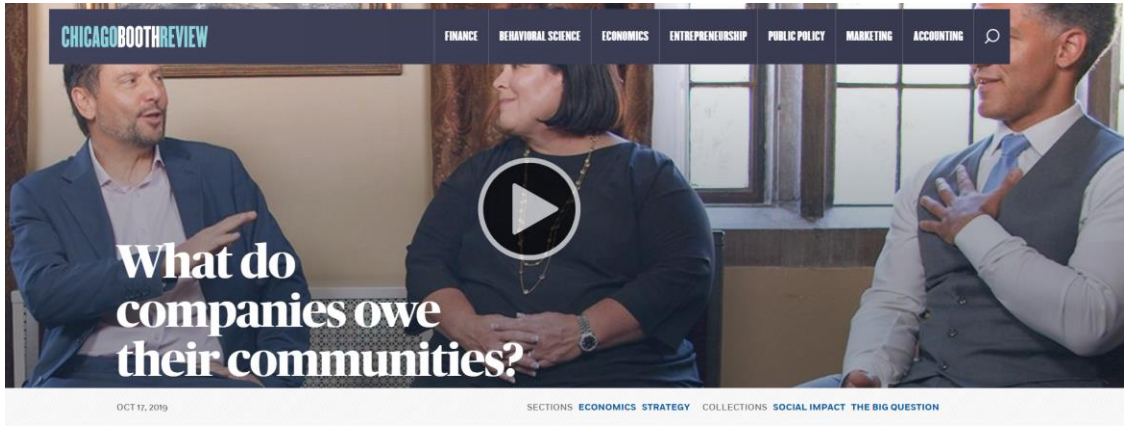
What does business owe society?
Experts from across the globe consider the Friedman doctrine and the social responsibilities of contemporary companies
Credit: Edmon De Haro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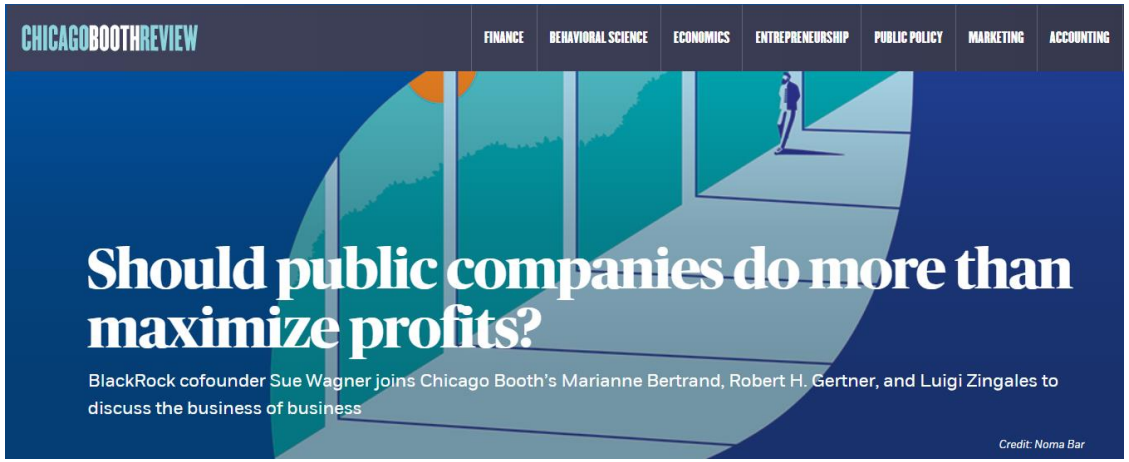
ACCOUNTING
What do companies owe their communities?
OCT 17, 2019
SECTIONS ECONOMICS STRATEGY
COLLECTIONS SOCIAL IMPACT THE BIG QUESTION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Should public companies do more than maximize profits?
BlackRock cofounder Sue Wagner joins Chicago Booth's Marianne Bertrand, Robert H. Gertner, and Luigi Zingales to discuss the business of business
Credit: Noma Bar

FINANCIAL TIMES

Milton Friedman was wrong on the corporation

The doctrine that has guided economists and businesses for 50 years needs re-evaluation

MARTIN WOLF + Add to myFT



Martin Wolf DECEMBER 8 2020

710

What should be the goal of the business corporation? For a long time, the prevailing view in English-speaking countries and, increasingly, elsewhere was that advanced by the economist Milton Friedman in a New York Times article, "The Social Responsibility of Business is to Increase Its Profits", published in September 1970. I used to believe this, too. I was wrong.

One view: Friedman is still right.

- Let free markets guide companies' decisions. Measuring "stakeholder" performance is too vague.
- Eugene Fama: If consumers want ESG, they should consume accordingly. ESG activists should focus their efforts on changing consumer behavior.
- Steve Kaplan: if companies do ESG, they should do so in a way that contributes to shareholder value, rather than detracting from it.

Another view: Friedman needs an update.

- Friedman's laser focus on shareholder value doesn't describe what actually happens (externalities, corporate clout)
- The Business Roundtable statement is too vague. Who are stakeholders? What exactly should we be maximizing?
- Luigi Zingales: shareholders have social and investing goals – focus on shareholder welfare, not simple value (the "Modified Friedman Principle".)
- Raghuram Rajan: maximize the value of long-term investors, including employees, suppliers,

Another view: Friedman is wrong

- Friedman's assumption of "free competition without deception and fraud" is totally unrealistic.
- Strong regulation is necessary to enforce rules and punish wrongdoing, yet Friedman rejects active govt
- The debate has moved on to how to measure social impact effectively.
- Anat Admati: stop corporations from writing the rules of the game
- Luigi Zingales/Oliver Hart: require boards of monopolies and firms too big to regulate (eg Google, Blackrock) to maximize social welfare.



Forbes

Jun 9, 2020, 04:53pm EDT | 2,999 views

Purpose At Work: How Big Brands Are Showing Their Support For Social Justice



Simon Mainwaring Contributor ⓘ
CMO Network
I write about how to drive growth for purpose-driven brands.

Harvard Business Review

We're Entering the Age of Corporate Social Justice

by Lily Zheng

June 15, 2020

Talk vs. walk in a crisis

Tyler Wry: Business Rountable Signatories (BRSs)

- BRSs were becoming more stakeholder-oriented pre-pandemic, but switched back to their old behavior once the crisis hit.
- BRSs that were returning the most money to shareholders before signing had the worst responses to the pandemic in the S&P 500.

Pradeep Chintagunta: Corporations respond to BLM

- Most big companies initially issued "words only" statements of support for BLM on Twitter, which led to an increase in negative sentiment
- Later statements promising concrete actions and

THREE BIG SHIFTS

	WHERE WE WERE	WHERE WE ARE
THEORY	Shareholder value	Shareholder welfare Long-term investor value Social welfare
DATA	Do ESG companies perform?	How should we ESG?
ACTION	Corporate social responsibility	Corporate social

hal.weitzman@chicagobooth.edu

review.chicagobooth.edu

(or just Google "Chicago Booth Review")



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NIRI Chicago -
IR Trends to Watch in 2021

Dave Sekera, CFA Chief U.S. Market Strategist, Morningstar Research Services LLC

February 2021

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Our Market Outlook

- Broad US stock market is overvalued by 6%
  - However, valuation skewed by overvalued mega-cap stocks
  - Value category only area still undervalued
  - Energy sector remains cheapest
  - Utilities fairly valued
  - Technology most overvalued

Source: Morningstar. Data as of December 31, 2020. Estimates/forecasts are indicative and for illustrative purposes only.

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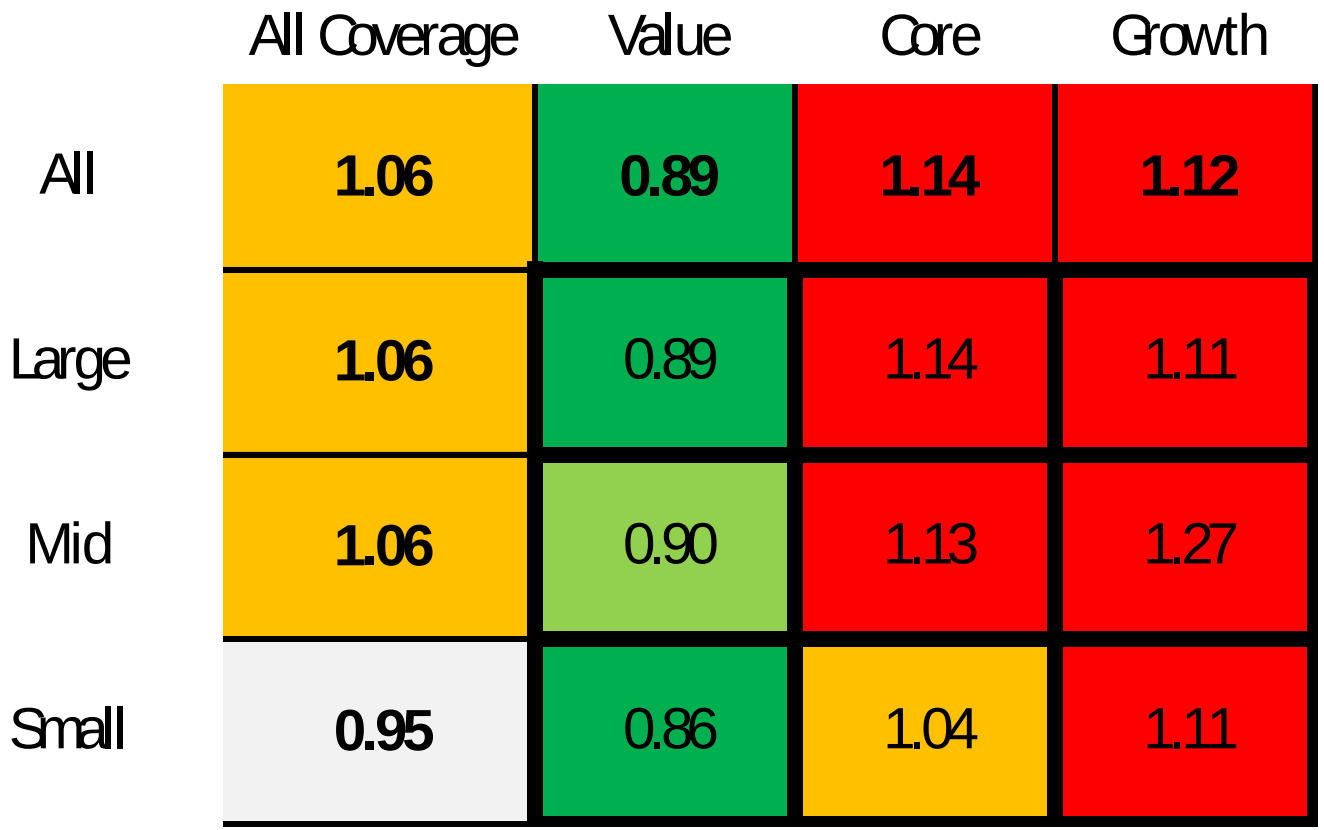
Our Market Outlook

- US economic outlook: GDP to rebound by 4.7% in 2021 and 2.9% in 2022
- Vaccine: distribution rolled out over 1H2021, widely distributed by 3Q21
- Interest rates: Lower for longer camp, federal funds to stay at zero until at least early 2024, longer rates likely to drift upwards by mid-year
- Corporate Credit Markets: back to pre-pandemic levels, record new issuance in 2020 to fund refinancing, acquisitions, and buy backs

Source: Morningstar. Data as of December 31, 2020. Estimates/forecasts are indicative and for illustrative purposes only.

U.S. Equity Market 6% Overvalued

Morningstar U.S Price to Intrinsic Value (P/FV Metric) Heatmap



Source: Morningstar. Data shown is the intrinsic price to fair value metric as of Dec 31, 2020. Past performance is not a reliable indicator of future results and data is presented for illustrative purposes.

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Key Themes in 2021

- **Environmental, Social & Governance (ESG)**
- **Capital allocation**
- Key Democratic priorities
- Economic normalization
- Corporate business tax hike?
- Resurgence of inflation

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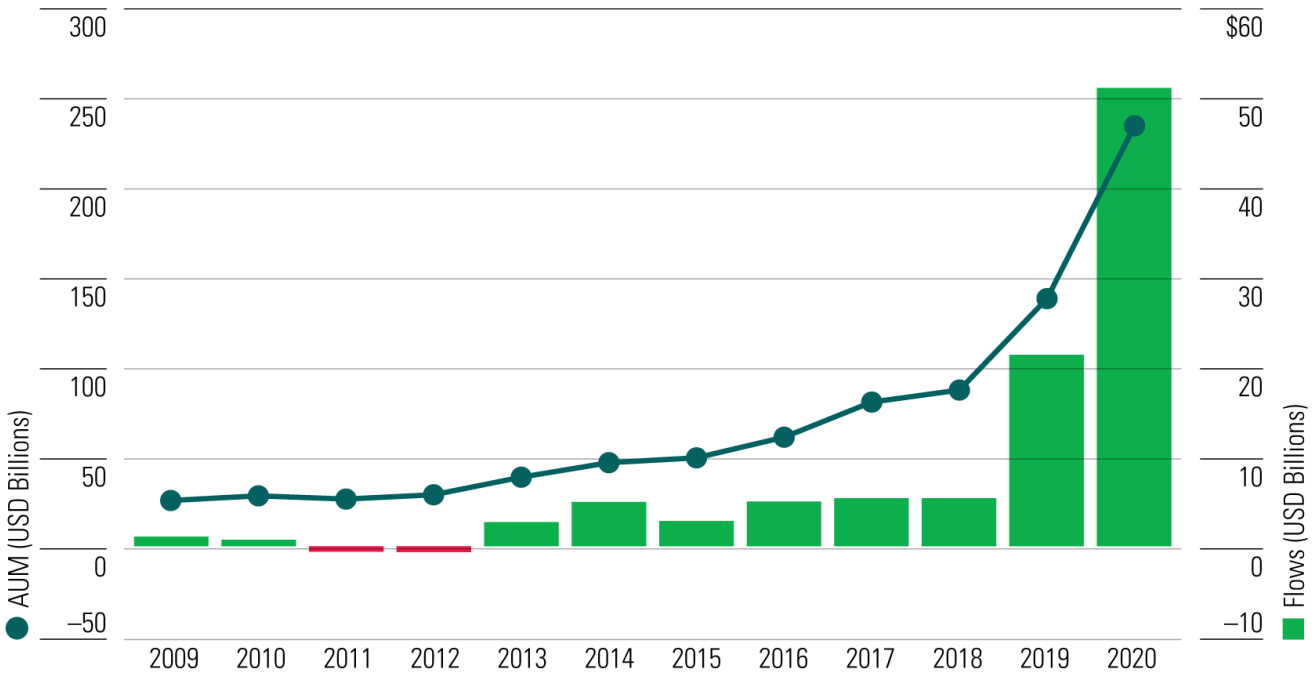
Flows for U.S. Sustainable Funds Again Reach New Heights

- Net flows of $51 billion in 2020 were more than double the total for 2019 and nearly 10 times more than in 2018.
- Sustainable fund flows constituted nearly a fourth of overall net flows into stock and bond mutual funds in the U.S. in 2020.

Sustainable Funds Annual Flows and Assets



Source: Morningstar. Data as of 12/31/2020.
Includes Sustainable Funds as defined in Sustainable Funds U.S. Landscape Report, Feb. 2020.
Includes funds that have been liquidated; does not include funds of funds.

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Sustainable investing broadening into ESG risk analysis

- Socially Responsible → Sustainable → ESG risk analysis / mitigation
- In midst of (r)evolution in ESG risk analysis
  - Education
  - Identification
  - Planning
  - Implementation
  - Measurement

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Investors are looking for guidance

- How to incorporate ESG risk analysis into valuation process
- Struggling with lack of consistent, standardized disclosure
  - Lack of direction on Human Capital Management reporting
  - Widely disparate Corporate Social Responsibility (CSR) reports
- Need to blend a mosaic of both qualitative and quantitative factors

Analysts looking to Investor Relations for help

- Management teams are increasingly being questioned about:
  - Current programs
  - Future plans
  - Economic value added / the impact on shareholder value
- Looking beyond management
  - Expectation for heighted board involvement beyond traditional roles
  - Board ESG Champion or ESG Committee

ESG risks being explicitly incorporated into valuation

- Morningstar’s equity research has recently formalized our ESG analysis into our valuation methodology
  - Consistency
  - Transparency
  - Common language

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Methodology overview

- Identify & estimate the probability and materiality to a company's intrinsic value related to ESG risks
  - Sustainalytics company-level ESG Risk Rating
    - Focus on most valuation-relevant Material ESG Issues (MEIs)
    - 20 MEI topics analyzed by Sustainalytics

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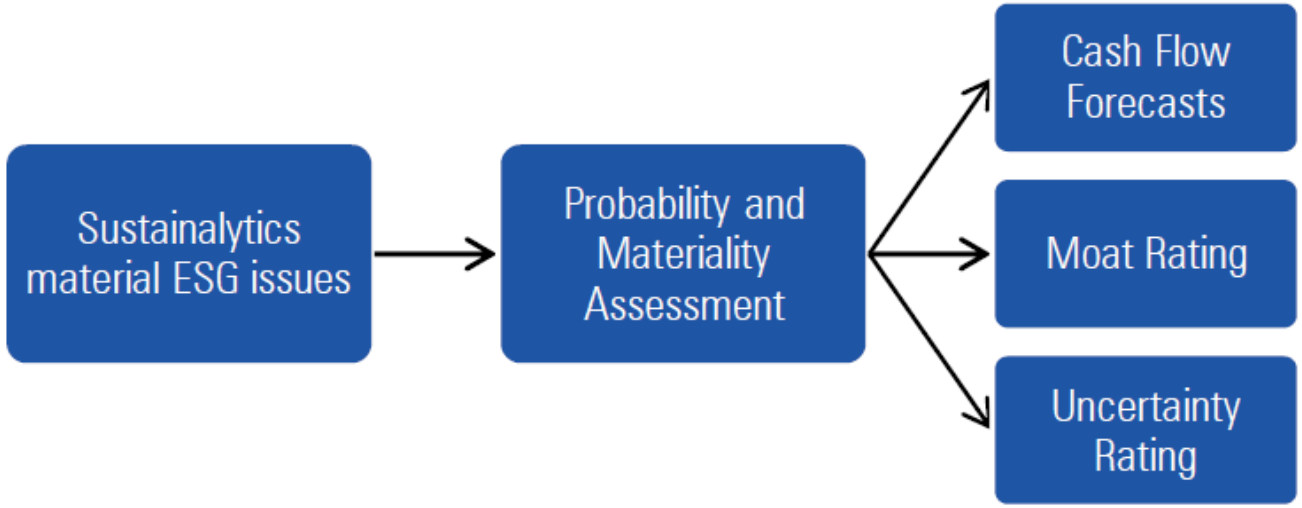
Valuation Approach



- Inclusion into cash flow model projection
  - Economic Moat Rating impact
  - Increased Uncertainty Rating

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Three areas of potential impact

- Cash flow impact analysis
  - if >50+% probability of occurrence: explicitly incorporate into DCF
  - >25+% but <50%: include into bull/bear case sensitivity analysis
- Economic Moat Impact
  - Assess if substantial threat of major value destruction
- Heightened Uncertainty
  - Cumulative score of low probability ESG risks that could have material impact to company

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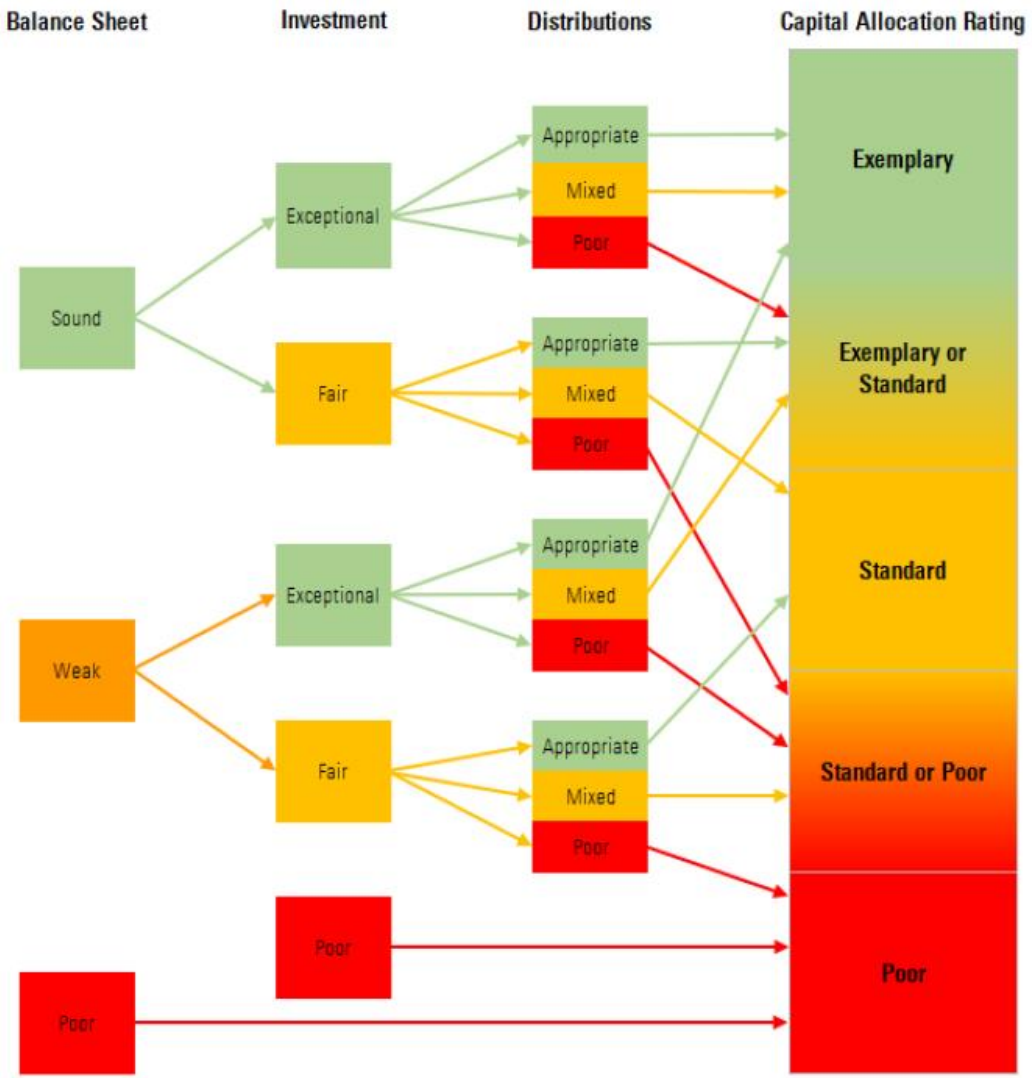
Capital allocation revisited

- Revised our Stewardship Rating to Capital Allocation Rating
  - Eliminate any confusion w/ ESG analysis
  - More focused on assessing management efficacy
    - Balance sheet management
    - New investment efficacy
    - Shareholder distributions: buybacks vs dividends

Capitol Allocation Revisited

- Decision tree for assigning capital allocation ratings
  - Balance sheet
  - Investment
  - Shareholder distributions



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Capitol Allocation Revisited

- Separation between companies which benefited from acceleration of trends due to pandemic versus those that have been impaired
- Balance sheet implications
  - Debt leverage versus record low interest rates
- Growth opportunities
  - Organic investments versus expensive acquisitions
- Shareholder distributions
  - Buybacks at all time highs or increased dividends

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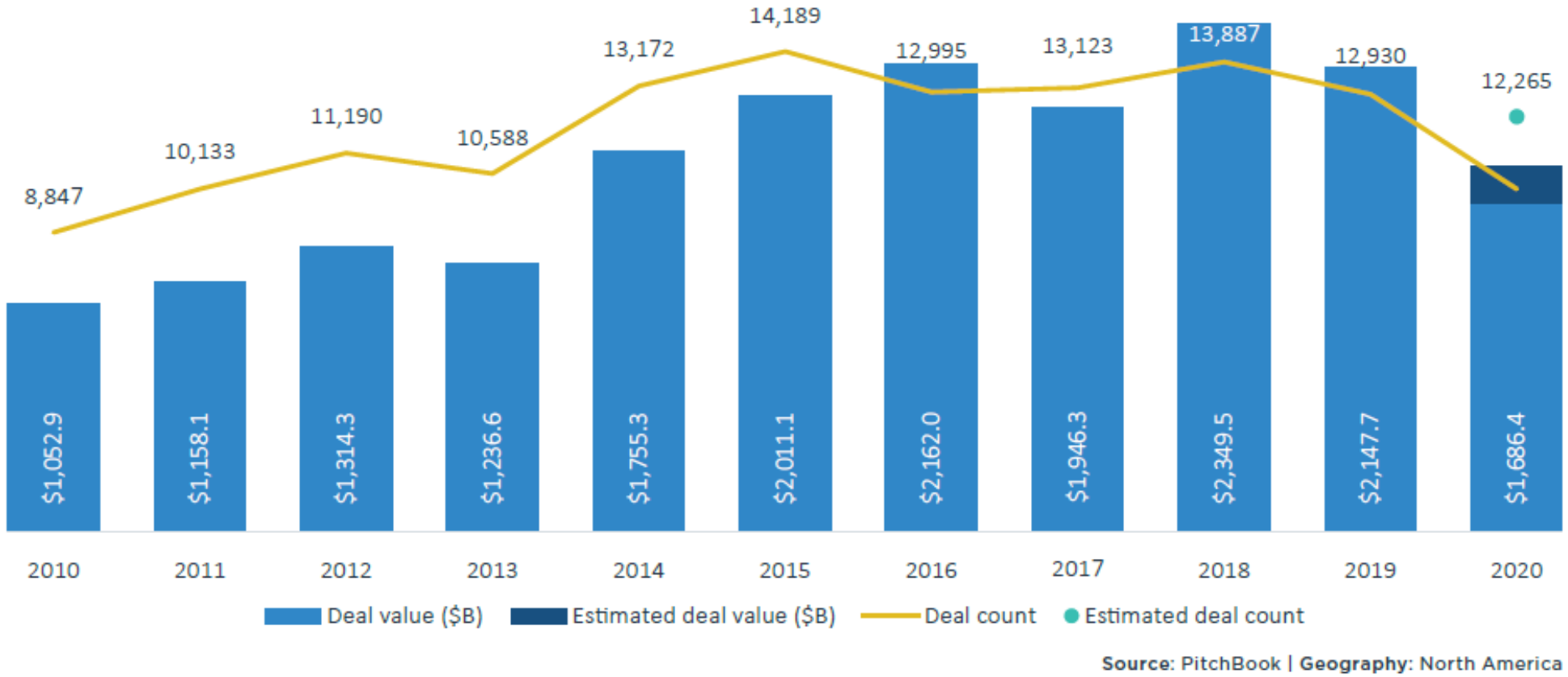
Appendix

- M&A activity dipped in 2020



Source: PitchBook | **Geography**: North America

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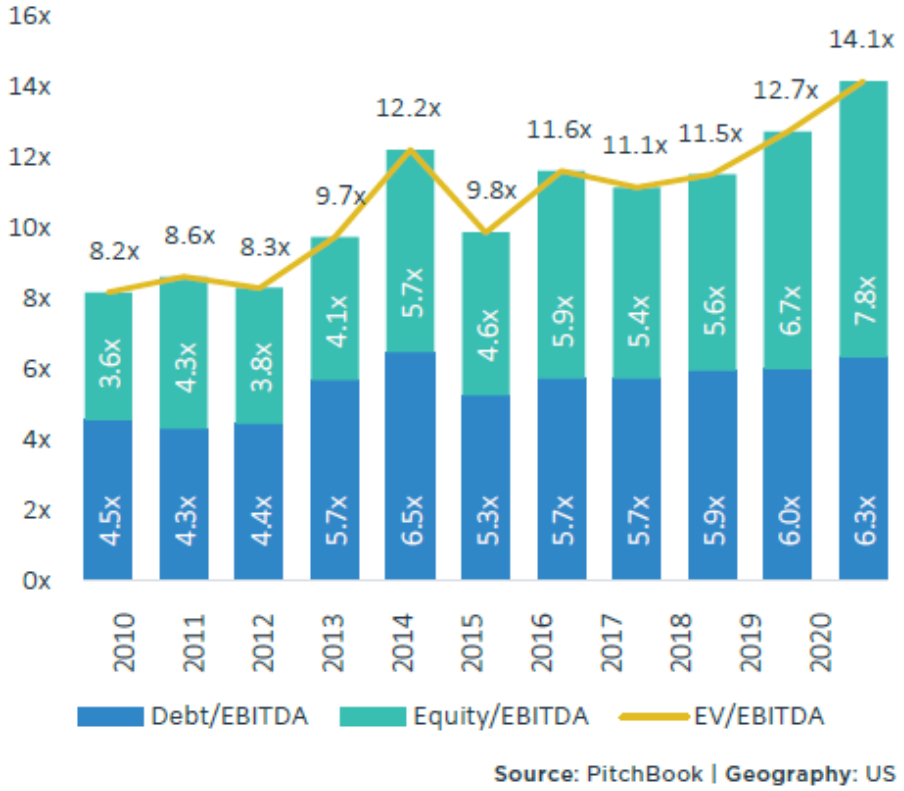
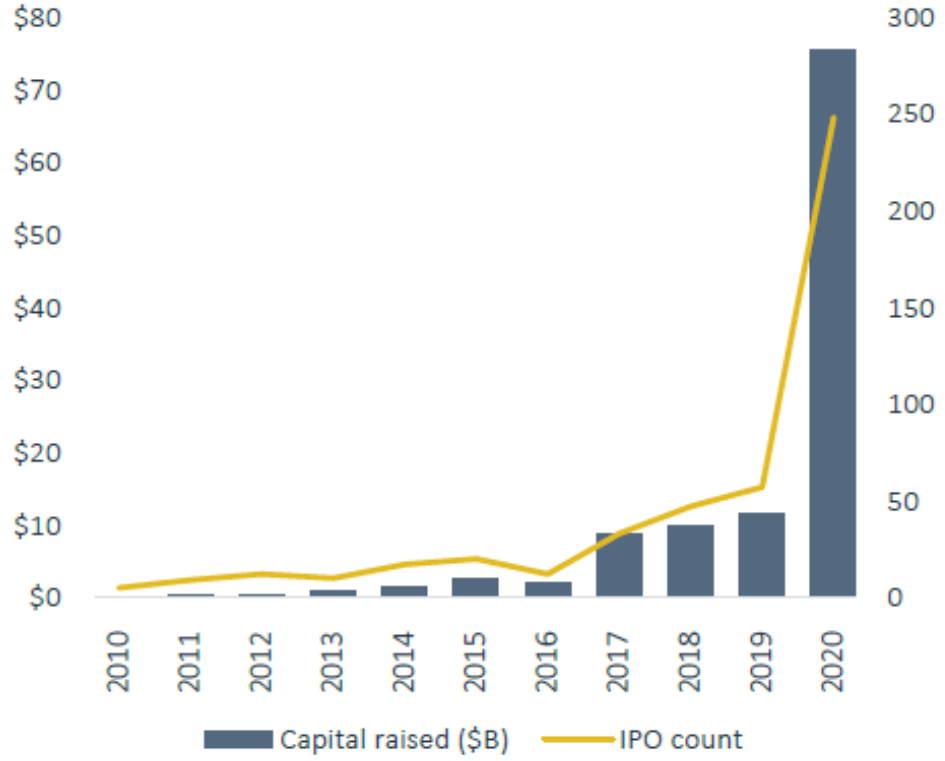
Acquisitions are expensive—yet even more investors hunting for deals

- Buyout multiples at



Source: PitchBook | **Geography:** US

- SPACs on the prowl



Source: PitchBook | **Geography:** US

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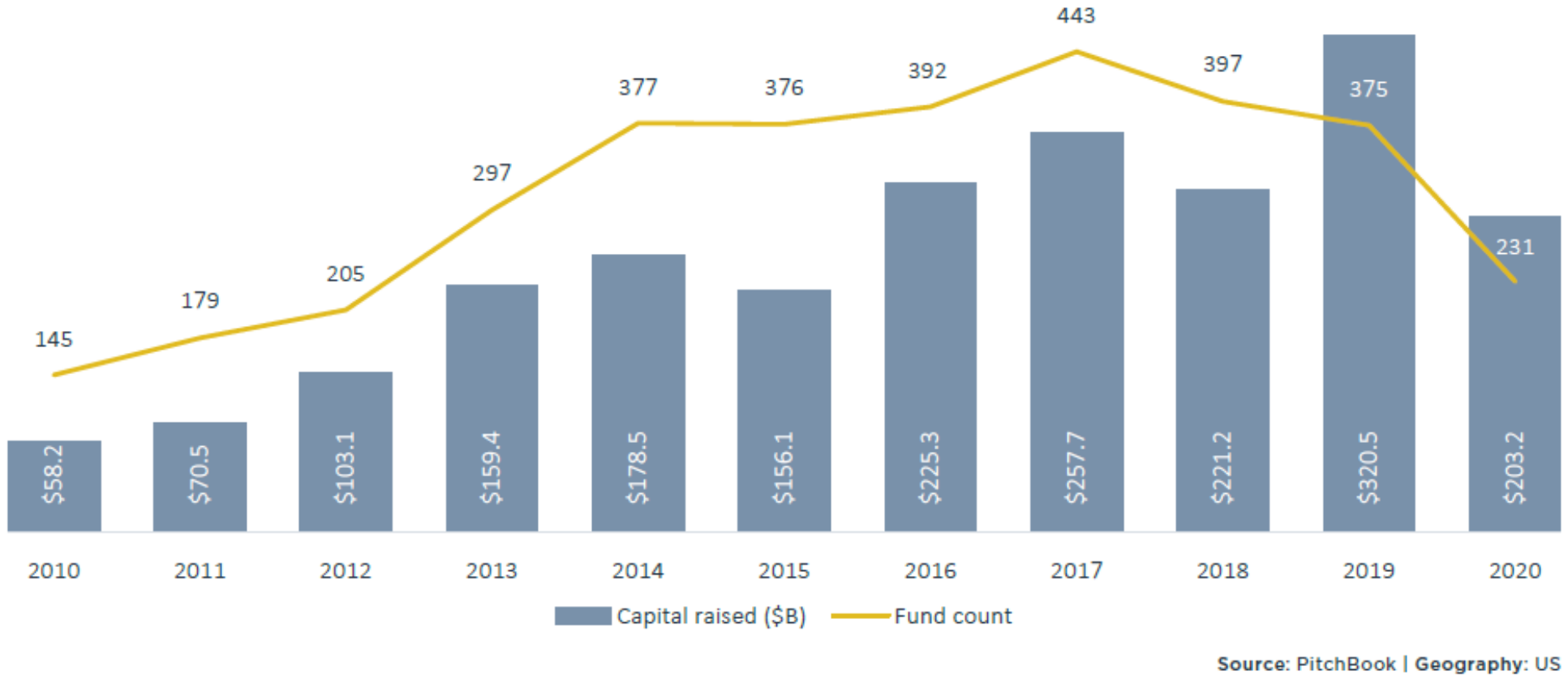
US PE Fund Raising Activity

- $1 trillion of dry powder available in private equity ma



Source: PitchBook | **Geography:** US

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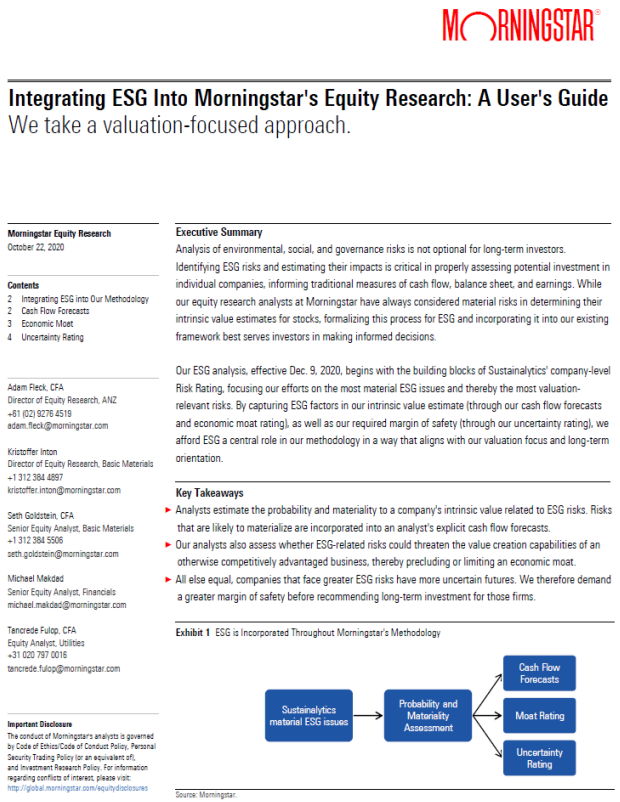
Additional information

Integrating ESG Into Equity Research



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Integrating ESG Into Morningstar's Equity Research: A User's Guide
We take a valuation-focused approach.

Morningstar Equity Research
October 22, 2020

Contents

2 Integrating ESG into Our Methodology
2 Cash Flow Forecasts
3 Economic Moat
4 Uncertainty Rating

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Executive Summary

Analysis of environmental, social, and governance risks is not optional for long-term investors. Identifying ESG risks and estimating their impacts is critical in properly assessing potential investment in individual companies, informing traditional measures of cash flow, balance sheet, and earnings. While our equity research analysts at Morningstar have always considered material risks in determining their intrinsic value estimates for stocks, formalizing this process for ESG and incorporating it into our existing framework best serves investors in making informed decisions.

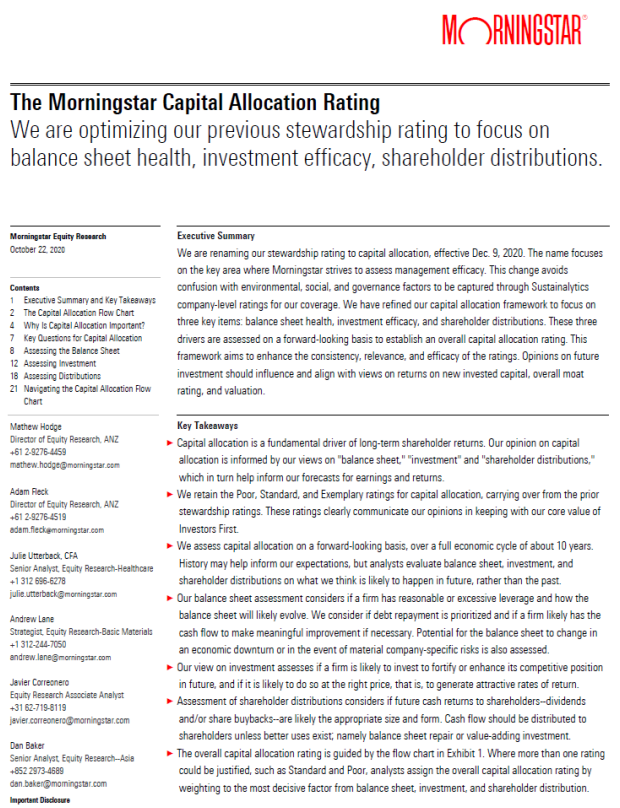
Our ESG analysis, effective Dec. 9, 2020, begins with the building blocks of Sustainalytics' company-level Risk Rating, focusing our efforts on the most material ESG issues and thereby the most valuation-relevant risks. By capturing ESG factors in our intrinsic value estimate (through our cash flow forecasts and economic moat rating), as well as our required margin of safety (through our uncertainty rating), we afford ESG a central role in our methodology in a way that aligns with our valuation focus and long-term orientation.

Key Takeaways
- Analysts estimate the probability and materiality to a company's intrinsic value related to ESG risks. Risks that are likely to materialize are incorporated into an analyst's explicit cash flow forecasts.
- Our analysts also assess whether ESG-related risks could threaten the value creation capabilities of an otherwise competitively advantaged business, thereby precluding or limiting an economic moat.
- All else equal, companies that face greater ESG risks have more uncertain futures. We therefore demand a greater margin of safety before recommending long-term investment for those firms.

Exhibit 1 ESG is Incorporated Throughout Morningstar's Methodology

Source: Morningstar.

Morningstar's Capital Allocation Rating



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The Morningstar Capital Allocation Rating
We are optimizing our previous stewardship rating to focus on balance sheet health, investment efficacy, shareholder distributions.

Morningstar Equity Research
October 22, 2020

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1 Executive Summary and Key Takeaways
2 The Capital Allocation Flow Chart
4 Why Is Capital Allocation Important?
7 Key Questions for Capital Allocation
8 Assessing the Balance Sheet
12 Assessing Investment
18 Assessing Distributions
21 Navigating the Capital Allocation Flow Chart

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Important Disclosure

Executive Summary

We are renaming our stewardship rating to capital allocation, effective Dec. 9, 2020. The name focuses on the key area where Morningstar strives to assess management efficacy. This change avoids confusion with environmental, social, and governance factors to be captured through Sustainalytics company-level ratings for our coverage. We have refined our capital allocation framework to focus on three key items: balance sheet health, investment efficacy, and shareholder distributions. These three drivers are assessed on a forward-looking basis to establish an overall capital allocation rating. This framework aims to enhance the consistency, relevance, and efficacy of the ratings. Opinions on future investment should influence and align with views on returns on new invested capital, overall moat rating, and valuation.

Key Takeaways
- Capital allocation is a fundamental driver of long-term shareholder returns. Our opinion on capital allocation is informed by our views on "balance sheet," "investment" and "shareholder distributions," which in turn help inform our forecasts for earnings and returns.
- We retain the Poor, Standard, and Exemplary ratings for capital allocation, carrying over from the prior stewardship ratings. These ratings clearly communicate our opinions in keeping with our core value of Investors First.
- We assess capital allocation on a forward-looking basis, over a full economic cycle of about 10 years. History may help inform our expectations, but analysts evaluate balance sheet, investment, and shareholder distributions on what we think is likely to happen in future, rather than the past.
- Our balance sheet assessment considers if a firm has reasonable or excessive leverage and how the balance sheet will likely evolve. We consider if debt repayment is prioritized and if a firm likely has the cash flow to make meaningful improvement if necessary. Potential for the balance sheet to change in an economic downturn or in the event of material company-specific risks is also assessed.
- Our view on investment assesses if a firm is likely to invest to fortify or enhance its competitive position in future, and if it is likely to do so at the right price, that is, to generate attractive rates of return.
- Assessment of shareholder distributions considers if future cash returns to shareholders--dividends and/or share buybacks--are likely the appropriate size and form. Cash flow should be distributed to shareholders unless better uses exist; namely balance sheet repair or value-adding investment.
- The overall capital allocation rating is guided by the flow chart in Exhibit 1. Where more than one rating could be justified, such as Standard and Poor, analysts assign the overall capital allocation rating by weighting to the most decisive factor from balance sheet, investment, and shareholder distribution.

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corbin

NIRI Chicago

February 5, 2021



Inside The Buy-Side® Survey Findings: Confidence on the Rise with High Expectations for 2021 Guidance

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Investors and Analysts Globally

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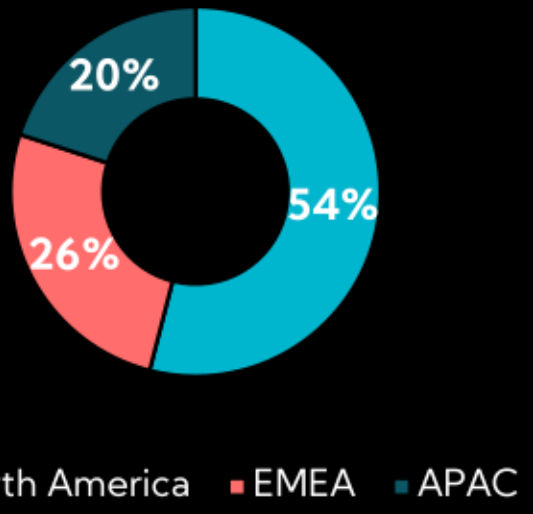
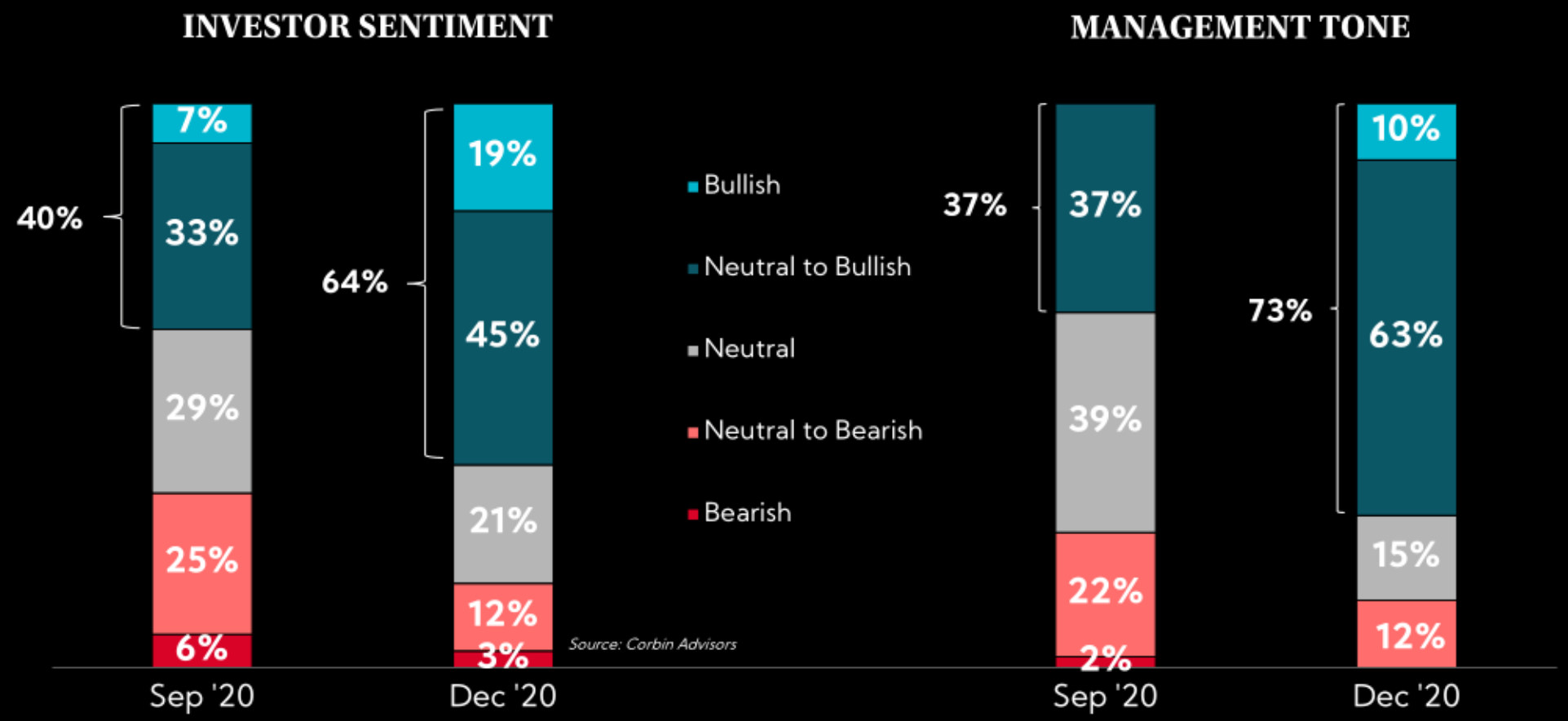


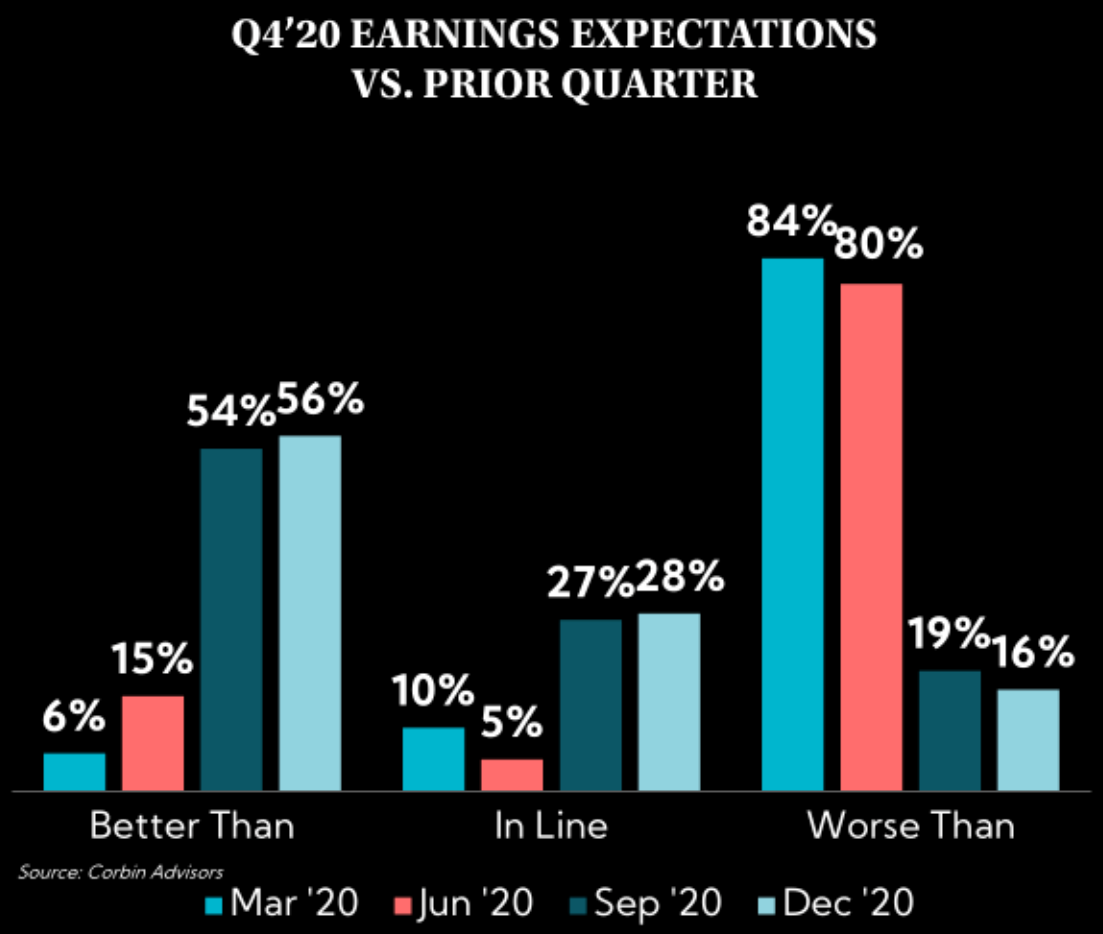
KEY FINDINGS

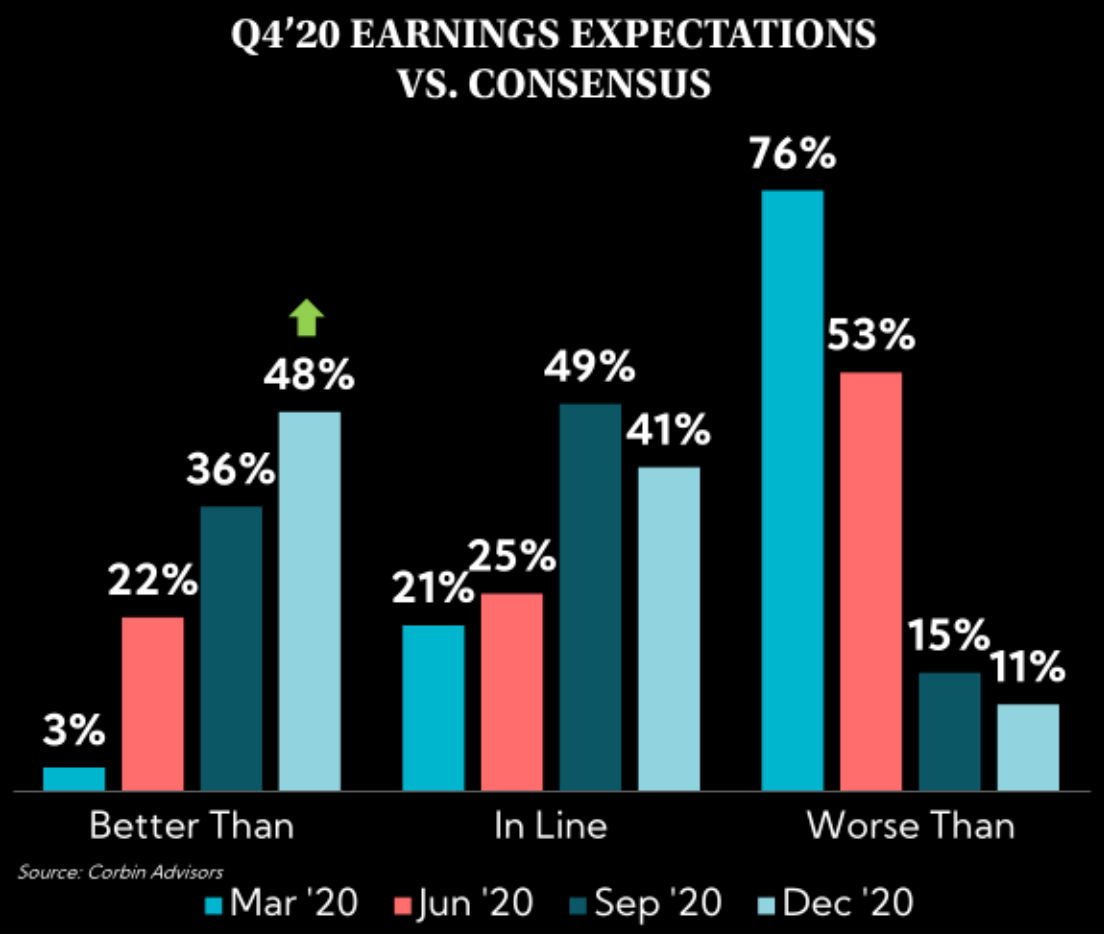
1. Expectations Suggest a Strong Q4 with the Majority of Companies Indicating They Will Provide 2021 Guidance, a Sign of Stability
2. Economic Indicators Expected to Continue to Strengthen, While Investors Voice Concern About Perceived Inflation
3. Human Capital Management is Gaining Momentum in 2021

Management Tone Perceived as More Upbeat; Almost Double QoQ and Near-record Highs



Investors Expected Beats and Baked in Improvement QoQ….





…And They Were Right

S&P 500 Earnings Scorecard – January

53% of Index

	EPS	Sales
Positive Surprise	83%	78%
5-Year Average	74%	65%
Blended Growth	1.6%	1.0%
Above / Below Consensus	17.3%	3.3%

EPS

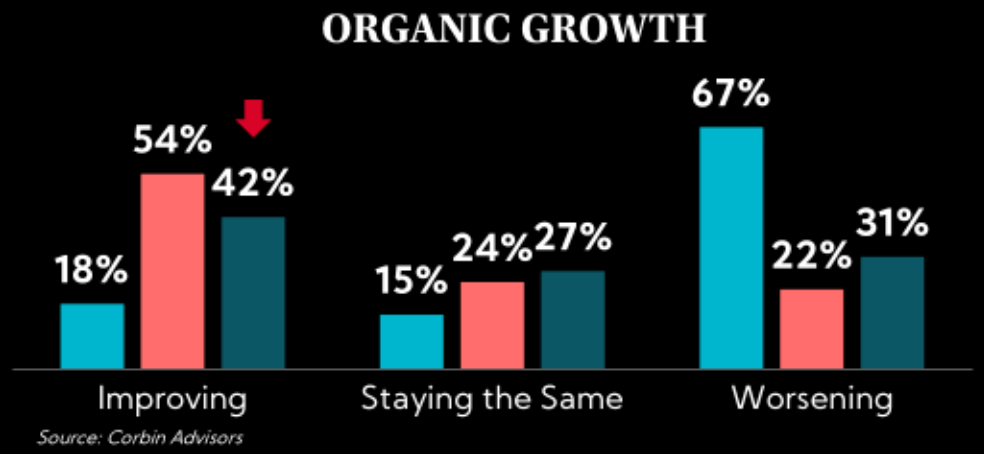
- Biggest Beats: Financials and Tech
- Biggest Busts: Energy and Industrials

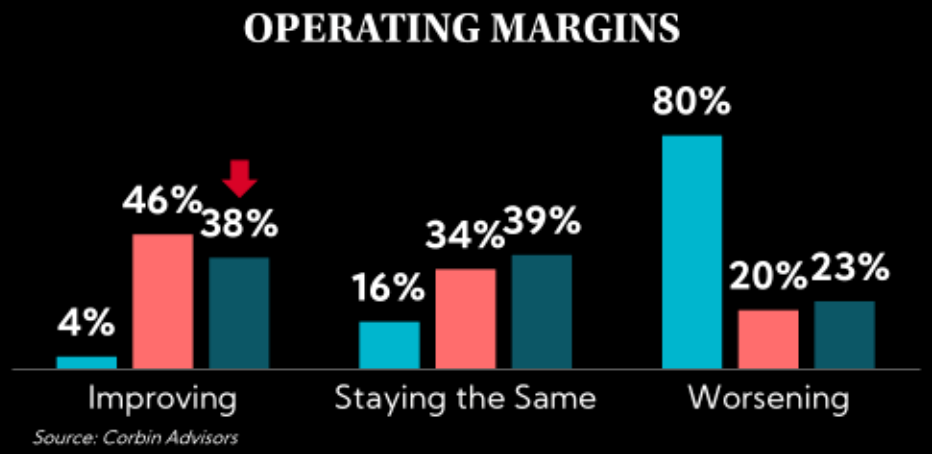
Sales

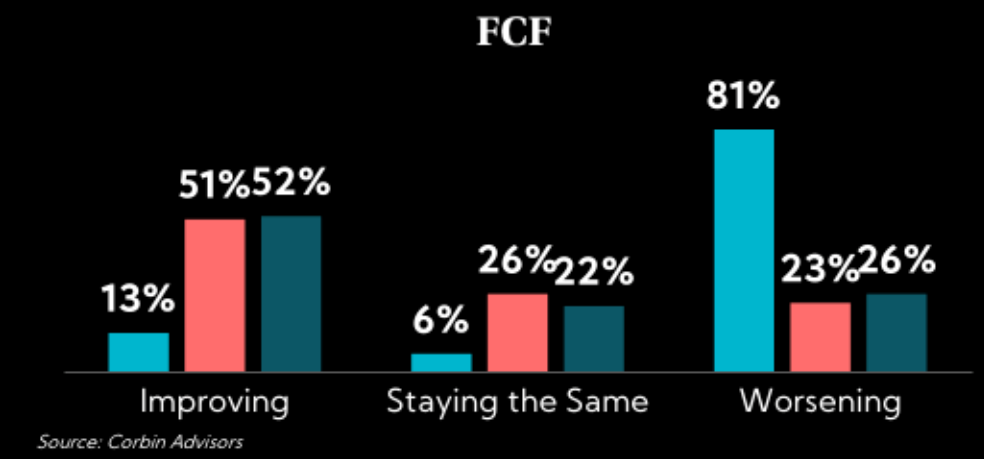
- Biggest Beats: Healthcare and Tech
- Biggest Busts: Energy and Industrials

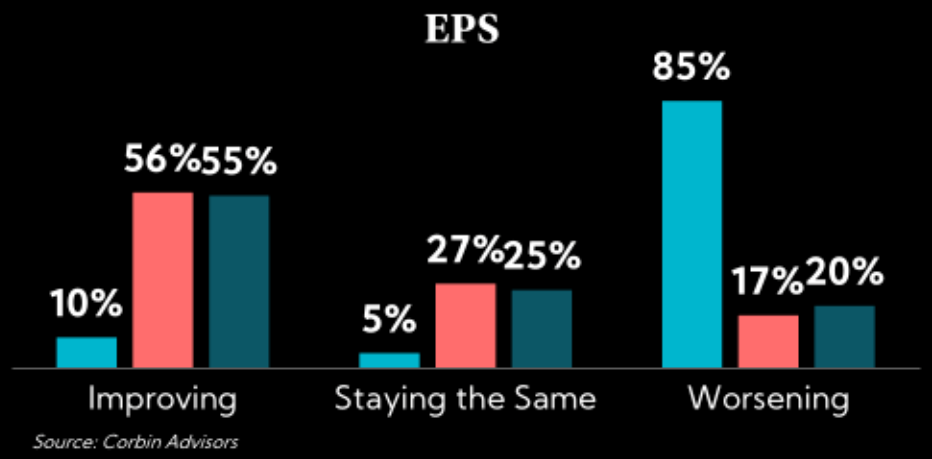
- Sell Side significantly more accurate with sales

More Continue to Expect KPIs to Strengthen; Views on Growth Ease Somewhat





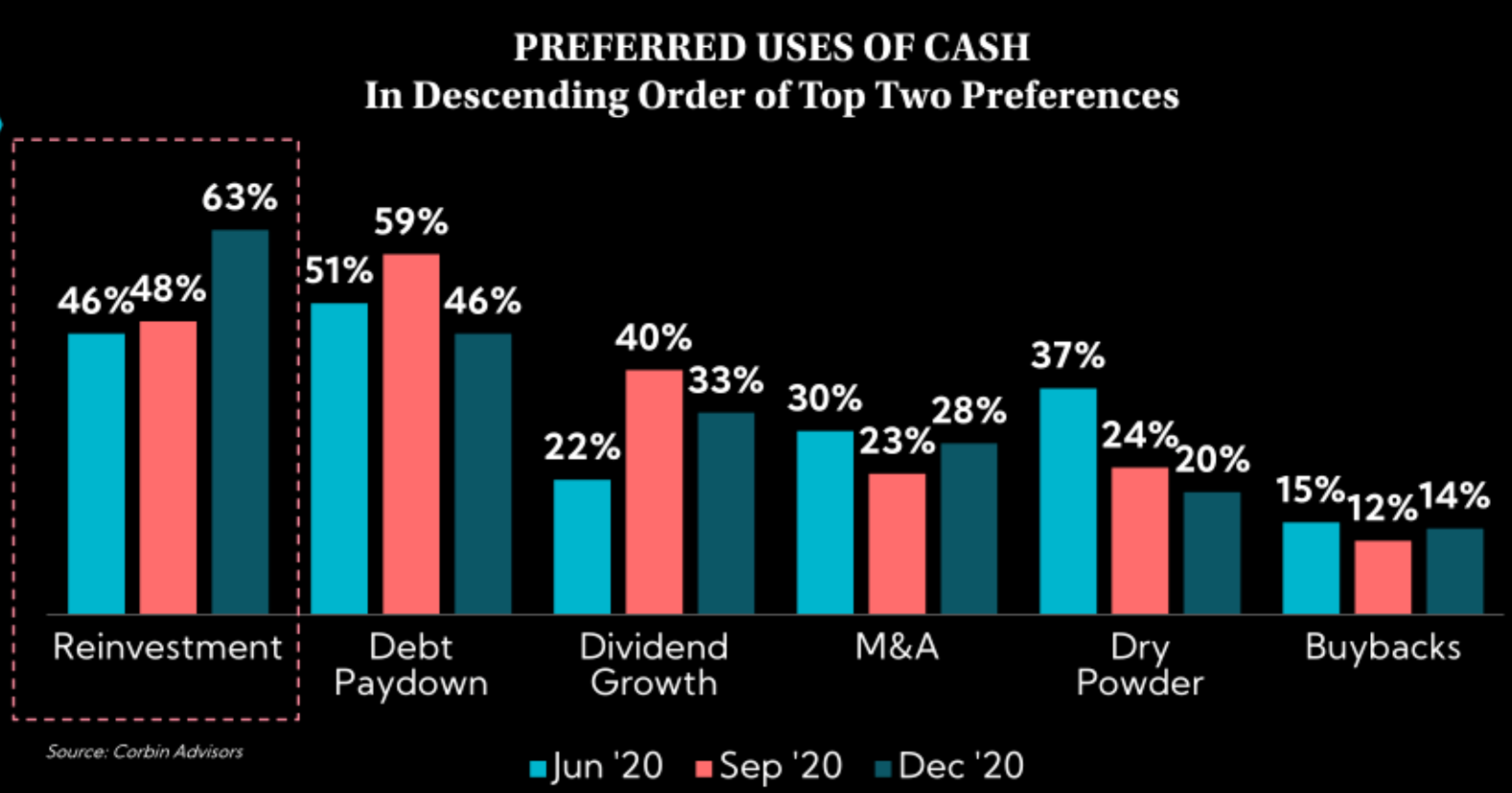




Corbin Research, Insights and Best Practice

FOUR KEYS TO CAPTURING INVESTOR MINDSHARE IN 2021

1. Investing in Growth **Reinvestment (and M&A in some cases)**
2. Managing Expectations **Guidance and Robust Color**
3. Embracing ESG **Human Capital Management**
4. Proactively Communicating **Virtual Investor Days**



Source: Corbin Advisors

Corbin Research, Insights and Best Practice

FOUR KEYS TO CAPTURING INVESTOR MINDSHARE IN 2021

1. Investing in Growth
   Reinvestment
   (and M&A in some cases)
2. Managing Expectations
   Guidance and Robust Color
3. Activating and Accelerating ESG
   Human Capital Management
4. Proactively Communicating
   Virtual Investor Days

Back in full splendor…guidance

- 89% of S&P 500 companies issued formal, quantitative guidance Pre-Covid, 68% of which gave annual outlooks
- 77% of investors expected companies to reinstate historical guidance practices for 2021
- Companies are largely reinstating guidance policies and continuing to provide robust color on expected performance
  - Granular, qualitative color on end market and geographic trends
  - Monthly sales trends
  - 1H / 2H performance cadence
  - Scenario analyses
  - Reminders and tough comp "watch outs"

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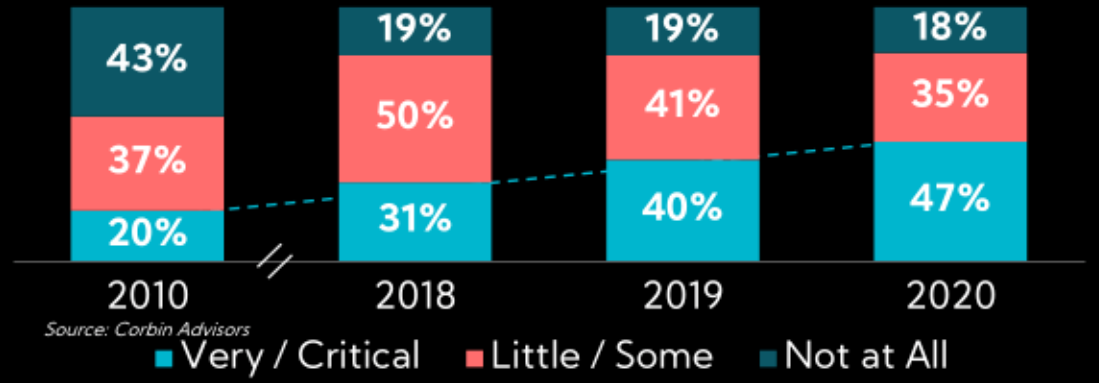
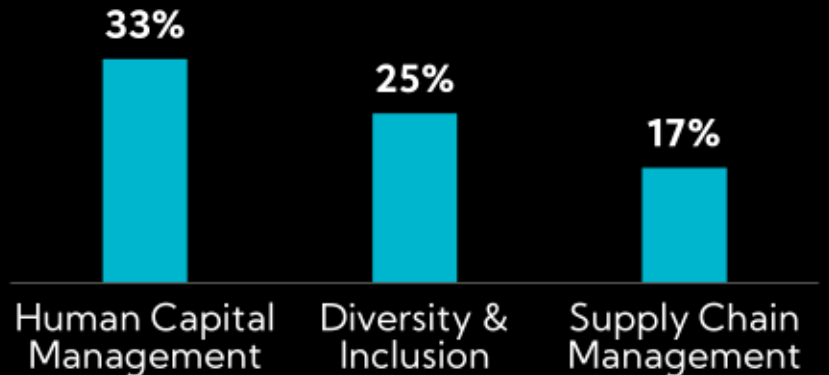
ESG IMPORTANCE TO INVESTMENT THESES



Source: Corbin Advisors

TOP 3 AREAS OF FOCUS IN 2021



Source: Corbin Advisors

54%
Note Companies That Took A Stand on Racial Injustice on Recent Earnings Calls Had A Positive Impact On Investment Decision

Corbin Research, Insights and Best Practice

FOUR KEYS TO CAPTURING INVESTOR MINDSHARE IN 2021

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2. Managing Expectations Guidance and Robust Color
3. Embracing ESG Human Capital Management
4. Proactively Communicating **Virtual Investor Days**

Virtual Investor Day

- 100% of investors believe virtual investor days are a good use of their time *(source: Corbin Advisors)*
- 63% of companies in Q4, an increase from 57% in Q2/Q3, provided long-term financial performance targets
- 87% held an event for at least 2 hours, one-third of which did so for 3+ hours

Virtual Value-adds

- 67% leveraged educational videos
- 30% included testimonials/customer discussions
- 24% provided facility visuals

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Realize Your Value

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Q&A

February 5, 2021



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Special thanks to AlphaSense and Q4, Inc.

AlphaSense Q4

Link to complementary 2-week trial from AlphaSense: https://go.alpha-sense.com/niri-chi-trial