GUIDANCE: THE ART OF SAYING NOTHING?

By Victoria Geddes*

The 2011 Annual Meeting season will be focused on two things – the shareholder vote on the Remuneration Report and the Outlook statement. Will the Chairman step in to fill the gap left by management commentary at the full year results in August, or leave shareholders guessing?

Two years ago we surveyed the reporting practices of 200 companies in relation to managing guidance. We were about to head into the profit reporting season for FY09 and there was considerable uncertainty as to what lay ahead. Market analysts were divided between managing expectations on the downside and upgrading forecasts in anticipation that the worst was now over. Our view was that since information is the life blood of financial markets, if a company chose to say nothing there would be others, undoubtedly less qualified, ready to fill the vacuum. In such an environment we asked "can you really risk saying nothing?".

The environment we are in now feels very familiar – global financial markets remain in turmoil, the All Ordinaries is at the same level now as August 2009 (4400) and opinion is divided as to whether the developed world is heading back into recession or has reached the bottom. As we head into Annual Meeting season for 2011 we thought it was time to review the lessons learned from the post GFC environment. Are increasing numbers of companies now working with their shareholders to help them make informed decisions about their investment for the year ahead or are they continuing to leave them in the dark?

Our findings were surprising and quite depressing. Even allowing for the fact the 200 companies we reviewed from the S&P ASX 300 (excluding the top 100) are not exactly the same as those included in our previous survey (FY08 results), it is the trend that is of most concern. What we discovered was that nearly half (48%) either omitted comment on the outlook in their August results announcement or deferred comment until the AGM. This compared with just under 20% in 2008.

The reason given by the majority for this inability to provide any guidance was the current volatility and uncertainty in global markets. Companies operating in the resource sector had particular difficulty with this. Of the 80 companies in this category just over 60% declined to give any view at all on outlook. The remainder provided qualitative guidance with a small percentage (5%) giving estimates of production tonnages for FY12. It would be fair to say that uncertainty goes with the territory for investors choosing to put their money into the resource sector. The many variables which impact on both commodity prices and production make forecasting profitability an exercise of calculating probabilities. So this outcome was not unexpected.

We were much more interested in the 120 non-resource companies of which 38% declined to provide any comment regarding outlook. Of those that did, around two-thirds (63%) provided financial guidance with the remainder focusing on more qualitative factors.

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In aggregate the incidence of those Australian companies we reviewed that provided either financial or qualitative guidance has declined over the past 3 years from around 53% to 36%. This falls well short of the US experience where 90% of the 269 National Investor Relations Institute (NIRI) members surveyed last year provided some form of guidance.

Financial Guidance

We were particularly interested to see if there had been any change in the quality of earnings guidance provided as this has been an area where Australian companies typically have not compared favourably. In the US where 80% of companies provide guidance on quantifiable financial performance measures, 58% offer **earnings per share forecasts**. In Australia only 2% of corporates we surveyed provided such guidance this year compared with 9% in 2008.

Other popular forms of **financial guidance** in the US include revenue (62%), capex (60%) and tax rate (59%).

US companies have also had to deal with the same frustrations of volatility and uncertainty experienced by Australian companies. Those that have undertaken to provide 'forward looking guidance' in the past have continued to do so. The CFO of US global consumer products company, P & G, responded as follows:

"Our guidance ranges will be a little bit wider than normal this year, reflecting a broad policy uncertainty, ongoing high levels of volatility and market growth rates, input costs and foreign exchange, as well as uncertainty both upside and downside related to pricing across the portfolio."

Qualitative Guidance

In June this year I attended the annual NIRI conference in Florida and made a point of attending one of the break out sessions on guidance titled "To Guide or Not to Guide". I thought this might provide me with some answers to this often asked question by Australian CEOs, but was surprised to find that this was not in fact the question. ***Guidance was assumed***, it was the manner in which it was given that was the issue for debate.

Aside from the nuanced discussion around financial vs qualitative guidance, the greater focus was on how companies could best provide shareholders with some sense of how likely trends or economic developments might impact on the business.

Examples of the most popular forms of **qualitative guidance** discussed included:

- Market conditions
- Trend information that may impact the business of the company
- Industry-specific information
- Market growth
- Estimates or forecasts of factors that may drive earnings
- Qualitative statements about high-level performance measures and KPIs
- Environmental, social and governance factors

Academic Literature

Greg Miller, an academic from the Ross School of Business at the University of Michigan offers a number of useful insights into guidance.

If a company <u>consistently</u> guides:

- its stock price will be more strongly correlated with future performance. This will be greatest if the company gives both short and long term forecasts
- analysts' recommendations are more accurate in the long run
- institutional investment increases
- there is a stronger relationship with analysts resulting in greater understanding and more 'forgiveness' when times are tough

Written Guidance Policies

Regardless of whether a company chooses to provide financial or qualitative guidance, we would recommend that a written explanation of its guidance policy be provided which includes:

- the thought process behind it in order to help outsiders understand the rationale
- specific situations when guidance will be provided and what form it will take

Most importantly the decision should then be discussed with key stakeholders.

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