GUIDANCE:
CAN YOU REALLY RISK SAYING NOTHING?

By Victoria Geddes*

This August reporting period, the spotlight will remain firmly focused on the last paragraph in the report, the one over which boards and management teams agonise – namely the commentary around outlook.

From the market's view point this will be the first set of annual results in which companies have had to report within the context of a global economy in full "financial crisis". Over the past month market commentators and analysts have swung between managing expectations on the downside and upgrading forecasts in anticipation that the worst is now behind us. What is clear is that there is no consensus of confidence so all eyes will be straining to see beyond the horizon of the current year, to glean from the usually perfunctory outlook statement some sense of the direction ahead – have we really passed the worst, is there more to come? Every word that is written or spoken at investor briefings will therefore be examined carefully not just for what it says, but for what is not said and to forensically read between the lines.

So what did corporates say last year and is there room for improvement? In our annual review of over 200 Australian companies results' announcements that reported in August 2008, we paid particular attention to the outlook statement. In doing so we focused less on what was said and more on how companies said it. Adopting the approach taken by a NIRI/CFA survey of investor relations professionals, published in May each year, we grouped the statements by type of guidance – "earnings guidance" (earnings per share or EPS), "financial guidance" (not including EPS) and "non financial" guidance.

We were particularly interested to see how Australian corporates stacked up compared to US companies as, in 9 years' communications advisory work, I have yet to come across any enthusiasm for providing guidance on outlook.

Paradoxically, when times are tougher, when there is heightened uncertainty and pervading gloom, when investors are desperate for any insight or indicator about what the future holds, the instinctive response for many boards and senior executives is to say nothing. The rationale for this may be legally based "if we don't say anything, we can't be held accountable " or, "there are just so many variables and unknowns that we'd be guessing – let the market draw its own conclusion". Others simply choose not to disclose at all. One example of this is a high profile resource company's standard advice to the market that "...it may prejudice the interests of the company to provide additional information in relation to likely developments and business strategies of the business of [the company] and the expected results of those operations in subsequent financial years".

Of the 200 companies we surveyed, just under 20% either omitted comment on the outlook, declined to provide any or deferred comment until the AGM.

In both Australia and the US, around 50-55% of companies provide "**non financial**" or **qualitative guidance**. The trick with this is to step into the shoes

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of the people who are trying to understand your business and provide them with the sort of information you would want if you were a potential investor. It is relatively low risk as the discussion is not about the business itself but about those market, economic or industry-specific conditions that have the potential to impact company performance the most.

In the last annual reporting season 53% of the group we surveyed offered some form of **financial guidance**. This could be either a specific forecast or range of a particular metric, or an estimate of growth for the year ahead. Net profit after tax (NPAT), distribution or dividend per share (DPS) and EBITDA were the most favoured metrics for this group with EBIT / EBITA a distant second, followed even further back by revenue. This falls well short of the US experience where 82% of NIRI members surveyed this year (86% in 2008) provided guidance on quantifiable financial performance measures.

To their credit Australian companies, in the last three reporting periods, have responded quickly to meet the demand for more disclosure around the size and composition of their debt portfolios. But when it comes to specific financial guidance there is often a nonchalant, almost cavalier approach that manifests itself through a lack of precision or rigour in the wording used by many companies. Where money or numbers are involved the choice of language and avoiding ambiguity is vital, yet we found companies talking about double-digit, single digit and teen digit growth; of earnings or profit without an accompanying definition and of unreferenced market consensus forecasts. One top 50 company for example noted in its investor presentation that it “expects 2008/09 profit before tax to be broadly in line with analyst consensus forecasts”. The following day a clarifying statement was released to the market defining “consensus” as covering a wide range, between $428 million and $1019 million, with an average of $751 million. I’m not sure that investors would have found this terribly helpful!

Where Australian companies typically compare poorly however is in relation to **earnings guidance**. Taking the purist definition (earnings per share) adopted by the US survey, only 9% of corporates we surveyed provide such guidance. This compares with 60% this year in the US, down slightly from 64% in 2008.

While disappointing, this result came as no real surprise, having observed over the past 5 years the trend to sideline EPS in favour of cash flow and EBITDA. In part this has been an outcome of an ASX initiative in 2003 to loosen the strait jacket of its “one size fits all” reporting format that had previously been forced on all companies. The philosophy behind this was sound as every company has different drivers underpinning their performance. There is merit in arguing, for example, that asset rich/cash flow poor companies or trusts holding assets with significant depreciation charges should focus on EBITDA and cash flow rather than NPAT. This does not explain however why in Australia so many companies, and indeed analysts’, have taken the opportunity to also abandon earnings per share - one of the most important investment metrics for measuring growth in shareholder value.

The US National Investor Relations Institute (NIRI) latest survey on Forward-Looking Guidance Practices, undertaken in April this year, concluded that “despite the recent extraordinary economic downturn, respondents’ public companies have generally made measured, rather than dramatic changes to their forward looking guidance policies”.

It will be interesting to see if Australian companies emulate this approach in the upcoming reporting season. As companies start crafting their commentaries for the year just ended, we would encourage them to step into the shoes of their shareholders and potential investors and ask themselves what information they can provide to help them understand the risks and opportunities they are facing in the year ahead. As an absolute minimum companies need to choose their words carefully so there can be no ambiguity or scope to misinterpret what is meant.

Information is the life blood of financial markets and if a company does not provide it there will be others, undoubtedly less qualified, who are ready to fill the vacuum. In the long run investors remember the companies that keep open the lines of communication and do not gild the lily. They will know their word can be trusted, in good times and bad, which goes to the heart of building credibility and corporate reputation.

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