

fowlstone  
communications

profit guidance  
research project

## **EXECUTIVE SUMMARY**

In July 2009 strategic communications firm Fowlstone Communications commissioned research into fund managers' perceptions of the way Australian listed companies handle profit downgrade announcements.

The research was conducted by detailed telephone interviews with ten leading fund managers from the following organisations:

- BNP Paribas
- Challenger Financial Services
- Deutsche Asset Management
- Eley Griffiths
- Global Asset Management, UBS
- Macquarie Funds Management
- MFS
- Platypus Asset Management
- Quest Asset Partners
- Third Link Investment Managers

The research is timely given the downturn in the economy and the expectation an increasing number of listed companies will issue profit warnings in the lead up to results season. This paper is the result of that research.

## **KEY FINDINGS FROM THE RESEARCH ARE AS FOLLOWS:**

Common irritations fund managers have with downgrades:

- Fund managers are most aggravated by selective disclosure of a downgrade.
- Another common irritation is announcements made late in the day or on a Friday.
- Failing to schedule a conference call and presentation after making a downgrade is another frustration.
- Fund managers are also annoyed when the downgrade is a surprise, or contradicts previous guidance, and when a company claims a downgrade is a one-off when it isn't.
- Director selling in a stock prior to a downgrade as well as downgrades issued immediately post a capital raising are also common frustrations, especially in the current economic climate.

## **COMPANIES**

Some of the companies named by fund managers for their competent management of profit downgrades include:

- BHP Billiton
- Bluescope Steel
- Iluka
- James Hardie
- Lend Lease
- Orica
- Qantas
- SAI Global
- Toll

## **TIMING**

Fund managers state the earlier a profit warning can be made the better. According to fund managers, directors should release material negative information as soon as it comes into their possession and should issue a downgrade before the market opens to give investors time to digest the information before trading begins. Companies making a profit warning should also consider halting trading in the stock before making an announcement, especially if information about the downgrade has been leaked.

## **COMPONENTS OF A DOWNGRADE**

What fund managers want most from guidance statements is the magnitude of the downgrade quantified. Fund managers state downgrades should include the following quantitative information:

- Detail about how much revenue will drop.
- EBIT and EPS figures.
- Cash versus non-cash items.

## **FACTORS THAT LEAD TO A DECISION TO SELL**

Poor credibility of management is the most common reason why fund managers sell a stock after a company has issued a profit warning.

## **MANAGING THE SURPRISE ELEMENT OF A DOWNGRADE**

Constant communication with the market and education about key drivers of a company's performance are important factors in minimising the negative impact of a downgrade.

## **RESTORING CONFIDENCE AFTER A DOWNGRADE**

Transparency, honesty and delivering on promises made are the key factors that can help to restore confidence in a listed company after issuing a profit warning.

The remainder of this document discusses these points in more detail and includes direct quotes (on an unattributed basis) from the fund managers who participated in the research.