

Getting prepped for reporting season

Earlier this week, Radar Group released its August 2010 "Reporting Season Primer". This bi-annual report is based on the findings of a survey of twenty one leading institutional investors. Investors were asked to identify what are the key issues they are focusing on as part of their stock selection process and the report then makes recommendations as to how companies can address these issues when communicating with investors.

The last time this survey was conducted was in November 2009. Back then, the key issue for institutional investors was operating leverage. Investors were looking to cash-in on the economic turnaround which was in progress post GFC by increasing their exposure to companies which had the greatest scope for earnings upgrades.

Moving on to July 2010, things are very different.

Now there are three key issues which investors are focusing on. They are: consumer leverage; sovereign risk; and the macro-economic outlook.

Consumer exposure tops the list of investor concerns. Investors are very worried about the outlook for consumer spending on discretionary items. The combined impact of the roll-off of fiscal stimulus spending, the recent barrage of interest rate rises and other increases in living costs means that disposable income levels have contracted significantly. Logically, this must flow through to reduced spending. Market earnings forecasts for the discretionary retailers remain optimistic and investors see material downgrade risk here.

How can consumer leverage be addressed when communicating with investors? – identify the share of revenues and earnings that are derived from consumer spend; communicate whether you see your product range as being more staple or discretionary in nature; and demonstrate any historical correlation between disposable income levels and revenues.

Sovereign risk has emerged from oblivion to be the second greatest concern for investors. This comes on the back of three key Government interventions over the past nine months. It started with the proposed structural separation of Telstra, continued with Healthcare reform and then shot to prominence with the "Resource Super Profits Tax" (now renamed the Minerals Resource Rent Tax).

Our new PM Julia Gillard may have eased concerns somewhat with her recent compromise with the miners, but it's difficult to see how someone so ingrained in the left faction of the Labour party can be anything other than interventionist in nature.

How can sovereign risk be addressed when communicating with investors? – demonstrate a strong grasp for the regulatory environment pertinent to your company and its sector; show an interest and understanding of the politics which are relevant to your commercial field; be pro-active in developing good relations with relevant Government and regulatory bodies and ensure that your commercial interests are being actively lobbied to these groups where appropriate; and finally, compose a compelling argument which will help to convince investors that adverse regulatory change is unlikely to occur in your commercial field.

The third key concern for institutional investors is the macro-economic outlook. Investors are currently placing greater importance on macro factors than on "bottom-up" stock specific factors when making investment decisions. This is due to the highly uncertain macro-economic outlook. Specific factors driving this uncertainty include: Eurozone sovereign debt blowouts; austerity measures and their potential impact on the sustainability of the global economic recovery; increasing optimism as to the US growth outlook; and increasing pessimism as to the Chinese growth outlook as the impact of fiscal stimulus rolls off.

How can the macro-economic outlook be addressed when communicating with investors? – demonstrate a strong understanding of the macro factors which impact on your business either directly or indirectly; provide detail to investors as to the geographical mix of export sales and earnings; provide detail as to the contract terms regarding export sales (eg: duration, pricing arrangements, take or pay); provide details of not only the direct geographical exposure of your projects but also the indirect exposure. For example, a mining contractor working on a job at a WA iron ore mine might have a direct exposure to Australia but an indirect exposure to China, supposing China was the key customer of the mine.

Be ready on these issues, because the questions are coming!

David Greer, Executive Director

