IHS Markit Perspectives IV (April 7, 2020)

Expectations for Q1 Earnings

IHS Markit's Perception Analytics team engages in in-depth discussions with investors and analysts daily. Given recent market volatility and significant economic uncertainty, IHS Markit will be speaking to investors and analysts on a regular basis over the next few weeks to assess how the current situation with COVID-19 is impacting their evaluations of and engagement with corporate issuers.

As more companies withdraw guidance due to the inability to confidently and accurately forecast their businesses (368 total as of the time of this publication, most in Medical Specialties, Retail, REITs, and Consumer Services), there are many questions around the level of transparency that investors and analysts require during the upcoming earnings season. **The fourth topic we gathered feedback on is market expectations for Q1 earnings messaging given unprecedented impacts to the operating environment in recent months.**

Surprisingly, many investors and analysts agree that withdrawing guidance may be the most appropriate move for companies at this time.

- "It is interesting that in just the last week, there have been a ton of cyclical companies that have actually pulled guidance. You are getting a free pass to do that because it is such an unusual backdrop, and I am okay with that. Usually you do not like companies to pull guidance, but you are seeing everyone do it. **If a company were to do that, really laying out why you have comfort in the balance sheet, cash flow, and the liquidity situation is more important than normal at this time.** Another thing on minds is supply chains from the risk side and how long will this take to normalize? One company I follow pulled guidance and stated that they were tracking ahead but pulled guidance because of uncertainty. Most companies have pulled guidance as a proactive measure. If you think you are going to lose money in Q2, then you should just put it out there. Investors are already prepared, so any type of messaging stating why guidance will be pulled would be helpful." *Research analyst, US sell-side firm*

- "Companies should withdraw whatever guidance they have for the year. Do not be a hero and try to project anything. I feel like we are going back to 2009. Focus on your liquidity and balance sheet strength. Make sure that people understand what effect a market downturn would have on your earnings and cash flow. **People can make their own assumptions, but companies need to present their underlying financials.**" *Portfolio manager, US investment manager (>$50B EAUM)*

- “Companies should talk about how they will be positioned going forward regarding capacity and utilization as there may be a bit of a mismatch over the next few years. If a company has exposure to highly affected areas, they can set expectations of how these disruptions might play through the year. I also suspect suspending of guidance across a lot of companies. A lot of the stocks have already been hit, so suspending guidance or being conservative with it would be expected. Depending on who the end customer is and what the end market is, there are some puts and takes. **A lot of the companies I cover might get a free pass with guidance just because we cannot say what is really going to happen in the space.**” *Analyst, US sell-side firm*

- “A good outcome would be for companies to not make light of the situation and pretend that they know the next steps. No one knows the next steps. Companies need to be forthright about the uncertainty and layout what the impacts to business will be. **It is okay if you do not know the impacts because the situation is still evolving. Companies do not have to provide numbers but frame it so that investors can know how bad things can be.** Everyone is cutting guidance at this point, so that is not the end of the world. Investors know that those numbers are not accurate. Scrapping guidance is acceptable. **Companies should not be preannouncing given that it is so early in the quarter.** It is better to wait until the earnings call to address it because if you do that now, the stock is going to get hit immediately as an overreaction. Companies need to be open to their investor base before heading into a quiet period. It also helps to maintain that openness post-earnings.” *Analyst, US investment manager ($800B EAUM)*

- “This is going to be a very interesting Q1 earnings period. People are going to be asking for things like what facilities are open, which ones are closed, and what are companies doing to either address cost structure or make sure that employees are retained incase this is indeed going to be V shaped. **One of the companies I cover did a COVID-19 call after markets closed and withdrew its guidance. I think we are going to see a lot of that because I do not think companies in general have a lot of visibility right now.** I found that COVID-19 related call to be very useful. The stock price of that company went up the next day in an environment where they just pulled their guidance before markets opened. The company talked about where it expects to see the most impact, the least impact, and went through it business by business and subsegment by subsegment. I think doing something like that is useful and companies should directly address the situation.” *Analyst, US sell-side firm*

Unsurprisingly, investors and analysts emphasize that it is most important for companies to conduct and communicate an honest assessment of the risk factors facing the business.

- “Companies need to answer the questions they are being asked, like what are the risk factors? How is the company actually managing those risks in the business? How is the liquidity situation? How is the company making sure it is not running out of cash? Does the company have access to capital? If these questions do not get addressed explicitly during the call, they will certainly be asked during the follow up. So, companies should discuss the impacts of COVID-19 very directly, that is what people want to know right now. If companies come out and say they are pulling guidance, not going to generate cash, and cannot get access to capital, then it definitely will not be positive. However, if companies are pulling guidance because they do not know what will happen but have plenty of cash and the stock has taken a hit, it may even create excitement for the stock going forward. So, if companies come out and discuss what they think the worst-case scenario is, some people in this market will make that the new base case. The question then becomes is that worst-case scenario accurate? Or, is it extra conservative or even too aggressive? **In the upcoming earnings calls, I want companies to frame the risks for investors, make it clear how they will be managing through the risks, and explain their capacity to absolve these kinds of shocks.**" *Portfolio manager, US investment manager (>$900B EAUM)*

- "Companies should be talking about the impact this is having on their businesses. **They should also discuss how this is affecting the balance sheet metrics in terms of what is happening to cash flow and how firms are thinking about mitigating variable versus fixed costs in order to stem the operational deleveraging that would otherwise occur.** Are there going to be any offsets against taxes? Arguably tax rates may not change but in the current regime, issues around tax are all important. Seeing how those balance sheet measures and liquidity metrics are being impacted and how they are being expected to improve would be extremely helpful. I can think of one company that for a long time did not want to comment about the impact of COVID-19. But it recently released what appears to be very realistic guidance where it assumed an appropriate percentage of its direct sales will be lost. It has also given some indication on what proportion of those sales have been offset by sales through other channels. The company gave guidance earlier in the year but that was clearly not prudent enough, so it has now changed its guidance and moved from forecasting low single-digit growth to a significant double-digit reduction. It has been very clear in terms of the assumptions that have gone into those figures. The firm has also chosen not to provide any guidance beyond its next reporting date." *Analyst, UK investment manager ($100B EAUM)*

- "Companies need to be transparent and honest. Management teams are usually salesmen, so they are pretty optimistic. **Just frame the ranges and be honest, even if it is bad news. With the current market environment, it is okay to state bad news as a result of COVID-19 instead of making up positive guidance.** I am sure they would never say that they make up good news, but some people do not like to admit uncertainty. Transparency and frequency of communication is key to reassure investors even if companies do not have anything new to say. If you are absent and investors cannot get in touch with you during a crisis, it makes them uneasy." *Analyst, US investment manager (>$5B EAUM)*

- "The timing of this crisis is quite late in the first quarter. As such, we will not see the impact in the US until the second half of March which is the last two weeks of the quarter. Normally, a company reports its quarterly results without discussing events after the quarter. **However, in this case, companies should talk about how things have trended intra-quarter and since the end of the quarter to provide additional guidance on how things have evolved.** The first quarter results are not likely to be affected by the coronavirus. Companies are definitely getting a pass to cut or change guidance, understandably so. **In terms of shareholder communication, some of the more proactive management teams that I follow are doing scenario analyses by stress-testing their business models under different scenarios.** This is done to reassure investors that everything will be fine. A handful of companies are actually hosting investor calls to run through a stress test and highlight a number of assumptions. These companies also discussed the impact on the balance sheet which I found very helpful because it showed investors that there was not much balance sheet risk." *Analyst, US investment manager (>$20B EAUM)*

- "Most companies have been addressing everything we would expect them to. **Having said that, providing additional guidance in terms of what impact COVID-19 is going to have on the business operations and company profitability will be helpful.** Companies should also really be focusing on their liquidity because that can be a problem for some of them in this environment." *Research associate, US investment manager (>$10B EAUM)*
- "I cover a lot of consumer names, so companies need to focus on addressing liquidity and how much cash and revolver availability they have on the balance sheet. Companies should detail cash earned. **It would be helpful if they gave their different case scenarios and how they are thinking about liquidity in this environment.**" *Portfolio manager, US investment manager (>$65B EAUM)*
- "Different companies will have different risks or opportunities ahead of them because of this situation. I think there just has to be a very honest assessment of what companies see in front of them. Firms also need to provide communication on any silver lining that there might be. There is always a silver lining in what is happening in the world. **So, during Q1 earnings calls, if management teams can give an honest assessment of what is happening to their business today and where they see it next week, month, or quarter, that will be great.** If there is a silver lining that is transpiring in their business, then management teams should be highlighting that as well." *Portfolio manager, US investment manager (>$10B EAUM)*

Some investors and analysts note that the market will ultimately reward companies that are proactive and conservative throughout this uncertain time.

- "Companies just need to show the investment community that they are being proactive. **It is very important for them to be proactive rather than reactive.** If their businesses really are resilient, then management teams will have the numbers to back that up. If that is the case, it needs to be highlighted." *Analyst, US investment manager (>$14B EAUM)*
- "Companies should try to give as much conservative guidance as possible knowing that there are a lot of unknown factors. **Give a scenario analysis. What is the worst-case scenario? Give some transparency and color of the playbook in this current backdrop. What are the unknowns?** Whatever color you can provide investors will always help. This is the time to think about margins and cost reduction given the current pressures on the business. How do you manage through that in the next 6 to 9 months? You know there will be revenue pressures, so it would be helpful if companies could quantify that or provide a roadmap. On the flipside, what are the levers you can pull on the cost side?" *Director of research, US investment manager (>$250B EAUM)*