IHS Markit Perspectives VIII (September 10th, 2020)

Framing discussions around valuations

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.

With most of the world's major stock markets experiencing volatility not seen since the financial crisis more than a decade ago, it is vitally important for issuers to understand how to engage and communicate with market participants as share prices continue to fluctuate. As such, **the eighth topic we collected feedback on is how companies should frame discussions around valuations given the extreme recent levels of market turbulence**.

Many investors believe it is inappropriate in most situations for companies to directly comment on their stock price as it is the job of the market to determine valuations.

- "I do not think it is the job of a company to talk about its valuation. It is the job of investors to value businesses and buy them when there is enough upside potential to offset the risk involved. I do not think companies should spend any time at all talking about valuations, with the exception of when it is engaging in M&A. **I would say that it is probably inappropriate for an IRO to try and court new investors by highlighting current, potentially lower, valuations."** *Portfolio manager, UK investment manager (>$100B EAUM)*

- "I have always found it tricky when companies speak about their valuations. **I think a company's actions are enough to signal its opinion on its share price.** But six months ago, many companies were signaling that they thought their shares were cheap by buying them back. When firms say that they are going to buy back shares, that tells people that the company considers the share to be cheap or at least reasonably priced. But again, I think the premise on which share buybacks start in the first place is really the area that needs to be focused on." *Analyst, US investment manager (>$50B EAUM)*

- "Companies should largely focus on running their businesses in the interest of long-term shareholders. **They do not need to engage in the discussions of valuations and where their stock prices are unless they will do an ongoing share buyback program.** What we find perplexing is that companies have dividend and share buyback programs that are ongoing, but when the stock price falls 30%, they stop the share buyback program. This makes no sense to us whatsoever because if you need cash, you should stop the dividend and continue with the share buyback program." *Portfolio manager, UK investment manager (>$10B EAUM)*

- "I do not think it is appropriate for companies to speak about their valuations. They should be giving guidance on how their operations are doing. Businesses should leave it to the market or analysts to think about valuation. **If a company does a good job with its operations and communication of guidance, then the valuation should take care of itself.**" *Analyst, APAC sell-side firm*

- "I do not think it is appropriate for companies to be commenting on their valuations. The valuation of something is very much in the eye of the beholder. Fund managers, analysts, and investment banks are the people that come up with the forecasts. Firms can of course mention the fact that they might be trading at a massive discount relative to NAV or book value. However, a lot of companies have rebounded since the bottom. A management team can always say that its share price looks very depressed. **But at the end of the day, it is the analysts and investors that decide what the valuation is because it is our job to forecast the future performance of the business.** I just do not think it is particularly appropriate for management teams to talk about their valuation. The most important thing is for management to give the market a decent account of what is going on and tell people how it is. Doing this is what is going to lead to higher valuations. Being very clear with messaging is very important." *Analyst, APAC investment manager*

- "I have never been a huge fan of companies speaking about their own valuations. I like to see firms talk about how they are responding to the crisis and the impact it is having on the business. **I am not sure it is necessarily a company's place to comment on its valuation unless there is some specific aspect relating to the valuation that the market is really missing.** For instance, if there was a certain part of the business that was particularly stable and makes up X% of its earnings and the market was misunderstanding that, then that would be one thing. It would be another to just say that the share price has gone down 20% because of COVID-19. I do not think comments like that are particularly helpful. Often when I have heard companies speak about valuations, it has just been them complaining that the share price is too low. But this is rarely accompanied by a reason for why the price should be any higher." *Analyst, UK investment manager (>$1B EAUM)*

However, many respondents wish to see firms provide guidance and commentary on their operations so the market can make the best assessment of valuation.

- "Valuation is not the job of the IR team. **It is the IR team's job to present the strategy and direction of the company in a way that investors can digest and do the work they need to in order to assess the valuation.** IROs can make this process easier and more transparent. But it is not the job of an IR team to go out there and scream "our stock is really undervalued". The market will already know that. It is better for IROs to make sure that investors do not have incorrect facts. The most important thing for IR teams to do is to make sure that the facts of the business are highlighted. We care about what the fundamental earnings power of these businesses looks like normally and what the valuation is today relative to that. Best-in-class companies do not 'hide behind the curtain' and provide less data. Instead, they provide the data and if the discounted valuation is temporary, then they should state why they believe that is the case. If there are positive things that could happen post COVID-19, then they should flesh that out. There are two reasons why stocks are undervalued. First, there is an uncertainty discount and the way to get rid of that is to be as transparent as possible. Second, markets in times of crisis are focused on the near-term and less focused on the long-term. This is a natural thing that an IR team cannot change." *Analyst, US hedge fund (>$10B EAUM)*

- "I am very skeptical when companies talk about their own valuations. I want to hear my companies talk about the state of the business or the industry. It is not particularly useful when companies have a presentation stating what its share price has done and what its valuation is in a promotional sense. If a stock is cheap, there is a reason it is cheap. If a company executes on what it set out to do, then the share price will take care of itself. I have never found it particularly useful when companies are talking about their own valuations. That being said, valuations are clearly based on a balance sheet or P&L metric**. If we are in a world where companies are not giving any sort of financial guidance, then actually understanding the real valuation of a company is quite difficult.** That is where companies can be most useful by giving ranges of guidance to help direct investors to where management teams think their companies are going to perform in a specific quarter or year. I would much rather a company give guidance based on what is the best information at the time and update guidance if and when necessary than not giving guidance at all. It becomes much more difficult to have a sensible conversation about how companies should be valued, either internally or externally, if the latter occurs." *Analyst, UK investment manager (>$50B EAUM)*

- "Companies need to be straightforward about their expectations as to what the financial impact from COVID-19 really is, what their expectations are longer-term, and what their underlying assumptions are with respect to COVID-19 and shelter-in-place initiatives. There is clearly a separation in valuations between those companies that the market thinks will be relatively unaffected by the pandemic on a longer-term basis and those that will be more affected. As a result, the market is disregarding what will actually happen in 2020. It has been willing to look past this year for certain companies that have been much more transparent in identifying and articulating what their underlying assumptions are with respect to the shelter-in-place impact and the longer-term opportunities that are available to them. **The companies that have been impacted the most and continue to have lower valuations are those that have been less transparent regarding the impact, and the duration of that impact.**" *Portfolio manager, US investment manager (>$100B EAUM)*

Some suggest that valuation volatility provides a unique opportunity for IR and management to increase engagement with new investors.

- "Companies should explain the fundamentals of the business, how resilient the business model is, and provide some color on the near-term impact of COVID-19. More importantly, companies need to focus on the long term. There is so much noise going on now that it is hard to have a clear view. It is better to highlight and focus on the resiliency of the business along with the long-term prospects when the new norm sets in. **This is definitely a good time for IROs to court new investors. Small group calls that sell-side companies do very effectively would be a good avenue to pursue.** If it is a new company and investors are already overwhelmed with their own holdings, they may not have time to have one-on-one meetings. However, investors can still benefit from a small group setting because they can still ask questions whilst also learning from other investors. Such a format is effective while not being too much of a burden to engage in. It can also be an effective catalyst to gaining interest. The current environment has created new buying opportunities for us, but it is a balance. I also have holdings that are going through a lot of turbulence, so I am occupied with that. This is why companies need to focus on courting new investors in a way that does not take a lot of time or effort away from an investors' current holdings. Such engagements can be a good starting point to entice investors to do a deeper dive on the company." *Analyst, US investment manager (>$25B EAUM)*

- "Investors who know companies very well are going to react less to the current volatility around valuations. If they do not know these businesses very well, then they panic from the volatility and sell the stock. **As a company, I would look for investors who have a good idea about my business and will be there to support the stock during drawdowns. Companies are always looking for these types of investors, and it actually becomes more important amidst this volatility.** The idea velocity has increased because there is a larger opportunity set to look from. In order to court new potential investors, companies should increase access to their management for investors. These days it is very easy because companies can go to any sell-side firm and say they want to host a virtual presentation. They do not even have to go to New York or any conference. Companies can just do it from home through Zoom. Companies used to have to restrict the number of investors that can join a meeting, but now there is no limit since everything is virtual. Companies should be having these calls pretty actively because it saves management a lot of time since they do not have to travel and can join from home." *Analyst, US hedge fund (>$50B EAUM)*