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What good is Corporate Guidance?

- *Over 60% of top 200 European companies do not provide detailed corporate guidance*
- *94% of analysts and business media in favour of more guidance*

Over the last 10 years, corporate guidance to the investment market has steadily increased in sophistication. From management having to decide whether it was "confident" or "concerned" about prospects in the mid-1990s, companies have moved to offering detailed assessments of their potential prospects to the point where specific targets for key metrics were included. However, our research suggests that, while the trend to quantitative guidance is clear, the number of companies actually offering it remains a minority. Of the 200 largest companies within the STOXX Europe Large 200, only 77 have offered specific, quantitative guidance for 2012. Although this is slightly more than 2011, we have been struck that over 60% continue to comment qualitatively or not at all. Indeed, as Nokia made clear at its 2011 results, many companies are making a virtue of not offering specific guidance.

This is not surprising. At the start of 2011, many companies predicted a more positive environment. As the year progressed, and macro-economic uncertainties grew, this view had to be revised downwards regularly. The fact that these revisions were often accompanied by share price reactions disproportionate to the impact on forecasts and valuations, reinforced the corporate view that specific guidance was simply a hostage to fortune and companies were better off not giving a view at all. In effect, corporate guidance was born in the bull market but died in the bear market.

Our survey of 140 investment professionals and business commentators refutes this view. Unsurprisingly, our responses, the majority of which were from analysts, showed a clear majority in favour of corporate guidance. However, the responses to other questions relating to guidance were more surprising and, therefore, we believe instructive.

When considering the interpretation of guidance, the majority of our responses stated that they would apply a premium or discount to the relevant number depending on the track record of the company and the users' own experience of the sector. A significant minority (39%) felt that analysts' forecasts were more reliable predictors of company performance while a similar percentage thought that company guidance was not timely enough. While some of our respondents understood that if markets can change so can guidance, it is also clear that a material proportion implied that guidance which was revised downwards would have a detrimental, i.e. disproportionate, impact on the company's valuation.

Top 200* companies in Europe – guidance offered

	2012	2011
Specific guidance**	77	69
No guidance	90	98
Yet to report***	33	33

* Based on the STOXX Europe Large 200
** Specific guidance is defined as quantitative predictions for future performance
*** As of 19th March for both years

We believe that our survey highlights a complicated relationship between companies and those who comment on their performance. While the views of the company are actively sought, they are analysed in considerable detail and any subsequent change, particularly downwards, is seen as an indictment of the management itself.

Yet, we believe that there is more to the question of offering guidance than for companies to simply bear the risk of the market's interpretation of change. Within our report, we highlight several qualitative responses. When considering which metrics are most important for guidance, several stated that it was less important to see an absolute number for revenue or EBITDA, for example, than it was to see predicted growth rates, margins and, critically, how the guidance was actually formulated. As one analyst put it, "*I would rather see guidance on key value drivers than on specific numbers.*"

These responses give a significant clue as to how companies can manage guidance to the market. In our view, management should depersonalise guidance by focusing on the factors over which it has control and providing a risk assessment of those that it cannot. For example, highlighting the capability of the organisation to withstand changes in demand, either through pricing, capacity or cost management, will be more helpful to commentators than trying to predict a final figure. Where possible, management should then outline the sensitivities of the business to key value drivers, such as commodity price inflation or customer demand, so that the market can then make its own mind up on the likely movements and their impact on company performance. Finally, our survey argues strongly for companies making the range in consensus forecasts available so that there is a better understanding of the context in which the guidance is offered.

By effectively partnering with the investment community through asking them to use guidance to make forecasts – which is, afterall, their role and not the company's – changes to guidance can be seen for what they are; reactive change, rather than failure.

The equity market is not perfect but it can be guided. Companies need to test the ability of the market's participants, both analyst and journalist, to understand comments which offer guidance but do not provide the whole answer.

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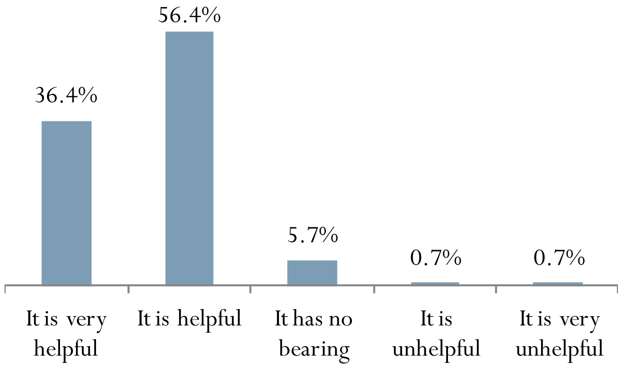
Scope of the Research

Between 9th February and 9th March 2012 Smithfield canvassed the opinions of 119 investment analysts relating to their views on company specific 12 month corporate guidance. The majority (93%) represent the 'sell side' audience, and analyse equities across the spectrum of sectors and regions.

The findings were supplemented by the views of 21 business journalists.

The majority of respondents are in favour of specific financial guidance

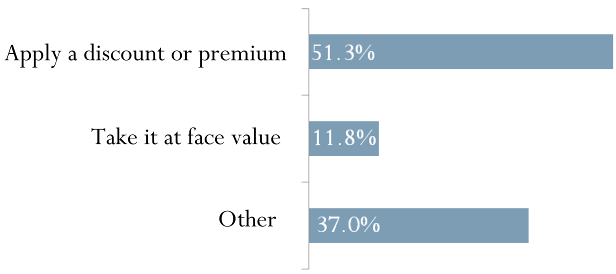


92.9% of respondents rate specific financial guidance as either helpful or very helpful. However, while guidance is helpful, many comments suggested that it cannot be relied upon as the only source of information in constructing the market's view of a company's likely performance. Indeed, guidance is viewed very much in the context of management's track record in predicting outcomes, the historic performance of the company and the wider market economic environment.

"If macro outlook is very uncertain, then 12 month guidance is hopeless."

"Consumer companies generally don't have an order book, which is why the guidance is very unreliable."

51.3% of analysts adjust according guidance while only 11.8% take it at face value

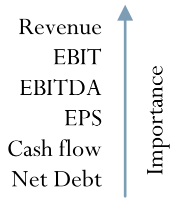


The majority of analysts (51.3%) apply a premium or a discount to specific financial guidance, whilst only 11.8% take it at face value. This reinforces the points made in answer to the question of whether guidance is helpful. Furthermore, respondents highlighted that they often take a view on whether management is naturally bullish or bearish when considering company performance and adjust their interpretation accordingly.

"If the company has a track record for establishing conservative guidance, I will factor that in to my thought process."

"Some companies are naturally optimistic or pessimistic and you learn this over time."

Top line and EBITDA preferred over EPS and balance sheet

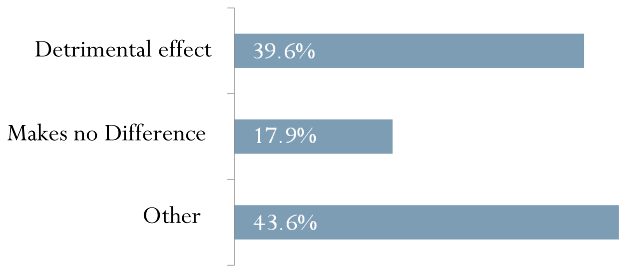


Reflecting the market's focus on earnings rather than cash, respondents rated guidance on the income statement over cash flow or balance sheet metrics. While perhaps not surprising, this result does not appear to acknowledge the current received wisdom that "cash is king" nor the importance of balance sheet strength to ongoing performance. Moreover, respondents give more importance to the top end of the income statement (revenue and EBITDA) than to EBIT or EPS. With restructuring and balance sheet management regular features of company reports, the influence of specific line items such as restructuring costs, changes in net debt and movements in tax rates on EPS beyond those apparent at EBITDA may account for the lack of stability in consensus forecasts. Critically, comments accompanying this result strongly suggest that respondents would rather see more detailed analysis of prospects than specific predictions.

"Often growth numbers and margins are more helpful than specific absolute numbers. However, it is equally important to hear the explanation of how a company is going to get to their guidance as the guidance itself."

"A company can only control its expenses, not its revenue. Specific guidance on expenses is the most helpful thing. It is the analyst's job to forecast the revenues."

No consensus on the reputational impact of a change to guidance



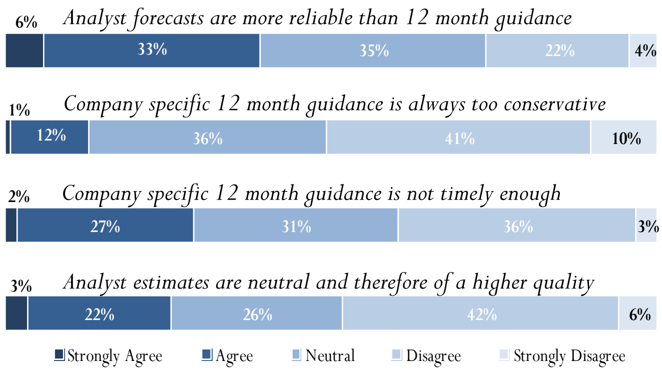
Only 17.9% of respondents agreed that a change in guidance makes no difference to the view of the company, whilst 38.6% believe that a change in guidance has a detrimental effect. Whereas some analysts understand that guidance can change and appreciate being kept informed, there are others who interpret a change in guidance as a failure of the management.

"The detrimental effect depends on the scale and frequency of changes."

"I prefer being kept informed and I understand that guidance changes as the year progresses."

"When a guidance is set and is changed, it can cause a lot of issues. So why give any?"

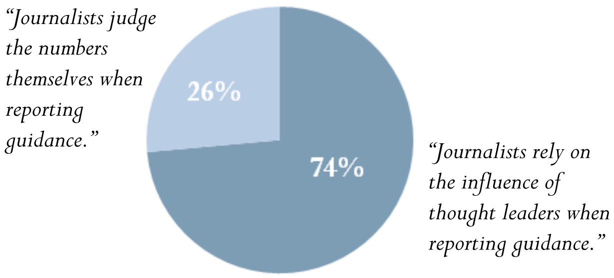
Analysts' forecasts (slightly) more reliable than company predictions



Although not a majority, 39 % of respondents believe that analysts' forecasts are more reliable for predicting performance than specific 12 month guidance. A third of respondents (35%) remained neutral and a quarter (26%) disagreed, implying that guidance is a component part of the "market view" of the company but that it should be seen in the context of analysts' forecasts. Only a quarter (25%) agreed or strongly agreed that analyst estimates are more neutral and therefore of a higher quality.

Over half of the respondents (51%) disagreed with the notion that company specific 12 month guidance is always too conservative and opinion is divided as to whether guidance is timely enough.

Business media are believed to rely on analysts' opinions when interpreting guidance

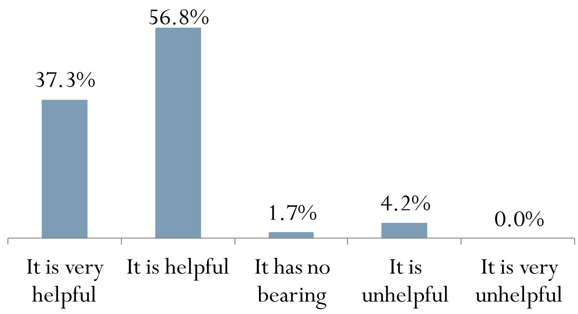


74% of respondents believe that journalists rely on the influence of thought leaders when reporting guidance, with only 26% holding the view that journalists judge the numbers themselves. While the reporting of analysts' opinions without providing analysis is not deemed a problem, there was some concern expressed that it does not help the wider understanding of the market's interpretation of guidance.

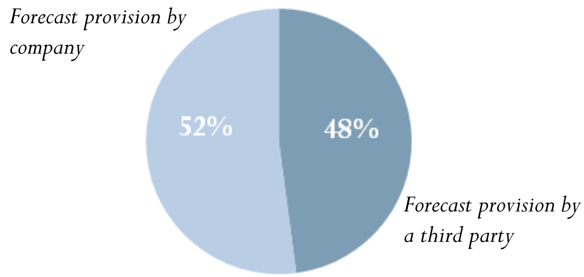
"Journalists are too history focused and mostly don't understand that it's about surprise versus expectation."

"Journalists always take the most basic … thoughts of analysts and they are not able to judge or to understand guidance."

The majority favour the publication of consensus forecasts



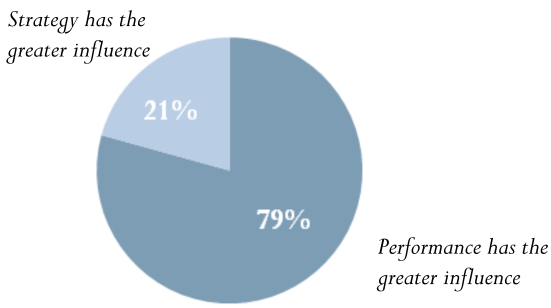
The majority of respondents (94.1%) believe that consensus forecast provision is either helpful or very helpful. However, there is no clear opinion whether forecast provision provided by a third party is preferable. Some respondents are concerned that consensus forecasts encourage "herd" behaviour, which results in too much management time spent managing the outcome.



"Having a clear understanding of what the market consensus is expecting is essential when looking for potential surprises, and in analysing actual results."

"It's helpful, but encourages herd behaviour in analysts and tends to result in companies spending too much time trying to control consensus forecasts."

Strategy versus performance



The majority of respondents (79%) believe that performance has the greatest influence on share price, compared to 21% who believe that the reverse is true. In the long term, however, the two are believed to be interlinked.

"Performance influences prices over the short run; successful execution of a good strategy influences it over the longer term."

"The market is too short-term so volatility is driven by performance and near-term measures."

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Institutions that took part in the Corporate Guidance Survey

Analysts
Baaderbank
BAML
Bankhaus Lampe
Barclays Capital
Bellevue
Berenberg
Bernstein
BHF Bank
BZ Bank
Carnegie
Cenkos
Cheuvreux
Citigroup
Close Brothers
Collins Stewart
Commerzbank
Danske Bank
Deutsche Bank
DZ Bank
Enskilda
Equinet
Erste Bank
Exane BNP Paribas
FIM
Fortis
Gilissen
Goldman Sachs
Handelsbank
Helvea
HSBC
HSBC Trinkaus
Inderes
ING
Jefferies
JPMorgan Chase
Kepler Capital Markets
Macquarie
Mainfirst
Medio Banca
Merck Finck
MM Warburg
Morgan Keegan
Morgan Stanley
Morningstar
Natixis
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NOS – Dutch Broadcasting Association
Reuters
The Scotsman
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