COLLECTIVE INTELLIGENCE

The Great Conversation Reset with Investors

Patricia Graue
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The coming earnings season is going to be a critical period in the great reset of the investor relations conversation with major shareholders.

Investors will be doubling down on companies that have the most compelling and consistent narratives about how they will navigate the economic challenges ahead without abandoning their long-term aspirations.

The shift in favor of companies balancing the trade-offs between growth and resilience began emerging during last quarter's profit reports, and those expectations will dominate the investor dialog with executives this time around. Executives should provide commentary that shows their mastery of the company's operations, a clear sense of the purpose of the company and well-reasoned expectations for the future in a tougher economic environment. Concise messaging on these topics conveyed with confidence will resonate with well-informed, long-term investors who are currently reevaluating their holdings.

Key takeaways

- Prove your company can pass the rainy-day test. Investors are looking for earnings commentary that focuses on plans to weather the current economic storm. They want to see a granular understanding of the company's operations, a clear sense of purpose and well-reasoned expectations for the future in a tougher economic environment.
- Be direct about the corporate priorities. If your company decided to put more emphasis on resilience over optimizing for efficiency and profitability (or vice versa), executives will need to provide a clear explanation and rationale. Investors want a window into the decision-making process.

2023: The year of the long-term investor

Many long-term investors bought shares during a more benign period when companies had a lower cost of capital and growth was emphasized more than profitability. Last year, they began reevaluating their holdings in light of the current period of rising interest rates and recession risk.

The window for companies to make the grade remains open in the second-quarter earnings season, though it will close sooner rather than later. Investors won't have much tolerance for companies that aren't prepared for the new economic realities, which didn't emerge suddenly like the COVID-fueled disruption of 2020.

For many fund managers, this is uncharted territory. On average, they are in their 40s and lack experience overseeing an investment portfolio through brutal economic conditions. That may make them more risk averse and in need of assurances about a company's ability to manage volatility. Any uncertainty from executives, such as discontinuing guidance, could be seen as a signal to sell.

How to pass the rainy-day test

Companies should discuss how they are making it through the economically rainy days of the last several months: well-informed, long-term investors want companies that can withstand challenging conditions, much like people want a house that can weather a storm.

1. Show granular mastery of the business. Management should disclose the macro-outlook for the rest of 2023 and discuss how variations will impact plans, demonstrating a definitive grasp on what they can and cannot control. Investors are looking for companies that will spot problems when they come up and take care of them.

- Executives should show they know every inch of the company by discussing economic risks to the business and its sector, providing concise commentary on what turmoil means for the business model.
- They should set out what actions they are taking to navigate any liquidity and balance sheet concerns. Discussing cool-headed moves they are making to mitigate risks shows a comprehensive grasp of all that is knowable about the landscape.
- It is equally important for management to share excitement about results, progress and areas of momentum in the business. They should provide a glimpse of what motivates them and what they see as bright spots in operations.

2. Address the purpose of the company. Companies should inform investors if they remain steadfast in their purpose or indicate if they are pivoting. Some investors may interpret fewer public declarations of a company's purpose as distancing from it.

- Management should provide a clear rationale for corporate reorganizations. They should state outright if they are trying to better position the business, getting ready for a sharp short-term decline in demand and revenue or just trimming costs that crept higher in recent years.
- If executives believe that responsible stewardship of the company is the driving reason for layoffs, they should say so. Expanding opportunities for employees, customers and communities sometimes requires tough decisions.
- They should discuss the materiality of the different choices they are making. For example, to invest in communities or keep the cash, or to make long-term investments in talent or maximize margin.

How to have the guidance conversation

Discussing the outlook when presenting earnings is a valuable opportunity to demonstrate reliability. Executives should express conviction about a couple of metrics and provide descriptive information on the items that may impact profitability: higher cost of capital, currency swings and changes in demand, pricing power and internal spending.

Management should spend the most time discussing topics that are under their control and that are important to investors.

Core considerations

- Disclose assumptions upfront. Let investors know what is incorporated into guidance on the impact of the higher cost of capital and on the current turmoil in terms customers, suppliers, sectors and geographies.
- Follow a guidance policy. Tell investors when guidance will be given and when it will be updated so they know what to expect.
- State the number and preferred metrics for evaluation. Companies should be clear if they want the market to avoid getting overly focused on one metric. They should also discuss how their issued guidance metrics compare to those used in internal planning.
- If companies must pre-announce earnings, they should do so as early as possible and say as much as they can. Avoid piecemeal disclosures and minimize questions about why the disclosures were not made earlier.
- Management will show visibility into the business if guidance is cut hard once, and estimates issued that create a believable floor.

Conclusion

Companies should provide a view on how they are managing the trade-offs between resilience and optimization. Their narrative needs to explain how they are reconciling the pre-COVID drive to increase margins and minimize cash balances with the pandemic-era focus on extra cash cushions and more reliable supply chains.

Now companies must constantly revisit the balance between resilience and optimization. Companies need to discuss both why their approach to managing costs and their capital structure is prudent for a high cost of capital environment and how they are adjusting their supply chains. This will provide long-term investors with a sense for how management will prioritize stability and profitability.

The coming earnings season will be a key moment for that conversation.

To continue the conversation

Patricia Graue, Director, New York
pgraue@brunswickgroup.com

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