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NO NEWS IS NOT GOOD NEWS

An earnings downgrade does not have to be a company's downfall.

Nothing tests the mettle of a management team like an earnings downgrade. But too often listed companies get into hot water for releasing too little rather than too much bad news.

An unexpectedly weak quarter or the shock loss of a key contract doesn't need to completely trash a company's share price. But negative news is always a trial by fire for leadership and only the brave prevail.

When Richard Umbers, former chief of Myer, faced analysts and shareholders in early February his exit appeared inevitable. It was not, however, the downgrade to the first half profit guidance that sealed his fate.

It was the fact Myer was announcing its third profit warning since July. The sorry tale of the grand dame of Australian department stores is all too common.

Fund managers and analysts argue companies need to release bad news to the market as soon as it comes to light and avoid the temptation of holding back additional poor results in the hope conditions will improve.

Too often the promised return to normal trading conditions set out in the earnings downgrade does not materialise and companies are forced to issue new guidance. This fundamentally damages confidence in the executive team as well as the board and business.

It's essential any change to earnings includes an update on the broader business. This is so stakeholders can get a clear picture of exactly how the business in its entirety is trading through challenging conditions.

Key numbers, including the impact of the downgrade on revenue, earnings-per-share (EPS) and earnings before interest and tax (EBIT), need to be high up in any release and the announcement needs to land early in the day, following a trading halt if appropriate.

Once the key financials are published, the management team must step up and openly answer questions on exactly what went wrong, why and what comes next.

Any reluctance to engage in this important forum, or answer questions openly and honestly, will be read as either an attempt to hide the truth or incompetence.

The earnings downgrade conference call is a high stakes game. But it's also acceptable for companies to admit there are risk factors that are tough to quantify.

If there's one thing the market hates more than bad news it's the uncertainty of no news or worrying rumours.

So selectively briefing fund managers and analysts is a bad idea. It annoys stakeholders not privy to the information and fuels the rumour mill.

When a company isn't commenting on an issue, the media and analysts will find someone who will, someone who almost certainly won't be as well informed as management.

This creates a second and potentially worse headache for a company already grappling with a profit warning.

Fund managers and major shareholders don't sell a stock on bad news; they dump shares when they lose confidence in a company's leadership team or if the explanation for a downgrade doesn't make sense.

Businesses with the courage to maintain open lines of communication following a profit downgrade will not suffer the same reputational damage or share sell-down as companies that go to ground.

Ultimately, the whole bruising process has the potential to strengthen trust in a business and demonstrate the openness and accountability of management.

The fastest way to restore trust is to meet new guidance, which means the numbers in any earnings downgrade need to be realistic and management must honestly discuss the risk factors and regularly update the market on these issues.

Trying to paper over a slump with immaterial positive news will only irritate analysts and fund managers. It can also raise concerns the operation's leaders don't really understand key earnings drivers.

Regularly updating stakeholders on progress following a downgrade is vital to reassure them the new strategy is on track and to bolster support for the new plan.

Because without the support of market movers like fund managers and major shareholders, a post-downgrade share price slump can quickly spiral into a rout with the power to take down the board, management and even the company brand – no matter what the news.

Investor expectations

- Good communication is central to the outcome – be open and honest.
- Be accessible and available to fully explain the downgrade – engage with shareholders, analysts and the media – don't pull down the shutters.
- Under-promise and over-perform – delivering on revised guidance is essential to begin the process of winning back support.
- Don't paper over the cracks with immaterial positive news – communicate honestly and openly and provide all the information the market needs to analyse the news.
- Timing is important. Details of a profit downgrade must be released to the market as soon as a major issue emerges and the announcement should land as early in the day as possible.

Illustration by Angelo Vlachoulis