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Explaining the Numbers

An argument can be made that listed companies that pay attention to explaining their numbers and giving guidance on forecasted performance along with a context of management strategy and direction do better in terms of their stock price than some others who prefer to “just let their numbers do the talking.” Stock analysts may have their own interpretation of business models and ratios but a spokesman for the company can present a narrative that connects the dots in a positive way. He is also open to questions about unusual spikes in certain numbers—that’s a one-time, non-recurring write-off of stale inventory.

Do companies that win the best annual report awards also perform better in the market? And conversely, do those that prefer to let rumors swirl around them uncorrected or even enhanced get to be undervalued by the market?

Just like the character discount or premium we wrote about in a previous column here, there may be a communications gap deflator that haunts particular stocks.

Maybe because Chief Financial Officers (CFO) are not usually known for their communications skills or verbosity, except when making a case for credit worthiness to banks or rating agencies, they tend to just release the numbers and leave it at that. (If the ratios and returns are great, do you need to say more?)

The relatively new function of investor relations, which listed companies are now assigning to more senior executives, is an exercise in getting numbers to tell a consistent story. The narrative that emerges is supposed to have a happy ending (or at least nothing too disastrous) which is believable, and no fairy tale. That this function by default ends up under Finance rather than corporate communications means that the one in charge of making sense of the metrics tends to be from Accounting. Even with pie charts and slides, numbers by themselves can be blah, not to mention capable of giving nose bleeds when released in a flood. Without a story, a deluge of numbers can be as exciting as watching a performance of "Merchant of Venice" without costumes or sets, and a missing Shylock.

Disclosure rules of the stock exchange and the inherent secretiveness of finance people (that's confidential) as well as a built-in reluctance to explain anything, except revenue projections with banks, conspire to belittle the importance of a compelling narrative for the company.

Should the function of investor relations be part of corporate communications instead of Finance? Maybe then the full narrative of the company will have some consistency and context, so that the spokesperson answering questions on reorganization, union unrest, market share, bidding prospects, regulatory challenges, and fraud investigations also understands the impact of all these on the numbers. A single story teller can present a more cogent plot that connects all the relevant ingredients to come up with a more edible narrative stew.

Even investors with assets under management in the tens of billions of pesos and a fully functioning research department tend to characterize companies that they track, buy, or dismiss outright with a single phrase. These phrases become stereotypes after a while, similar to racial profiles that feed on our prejudices: Japanese are punctual; Swiss bankers can keep secrets; Filipinos are easy-going and tardy, also gossipy and soft in negotiations. For companies, the caricatures can be just as sweeping and unfair: too much debt; no rhyme or reason for acquisitions; badly managed; quarrelling siblings and factions with a patriarch having bouts of dementia; sunset industry; no succession plan; one-man Excom.

These characterizations, often negative, are the result of what the 1967 movie, "Cool Hand Luke" calls a "failure to communicate.” Without a functioning communications program, the numbers can't really explain themselves. They need context and justification. A high debt level for instance needs to consider the maturity of the loans, the cash flow to service them, and the comparison of the leverage ratios to peer companies. Does it make a difference if a company, characterized as highly leveraged, pays its debts a year before maturity? Thus "high" is not an absolute value but relative to other factors which a good financial communicator should address when dealing with investors.

The default reporting of the investor relations function to finance rather than communications, mainly because of access to the numbers, needs to be reviewed. However, the skills set for the right communicator needs to veer away from mere glibness and cosy relationship with media. It has to expand to familiarity and even comfort with numbers so that a compelling narrative supported by facts can be credibly promoted. The numerate individual, who is also literate and can quote Bassanio in *Merchant of Venice*, can best explain what the numbers mean.

As in regular PR, the importance of constant communications and putting the company in a favorable light or even controlling the damage of unfavorable events is underrated. It seems that only in a crisis when firemen and bomb squads are on the scene is PR called in, if only to get the CEO out of the line of fire. By this time, it is crisis PR practitioners that take over. And these are a different breed of communicators used to frenzy and mayhem and costing more in terms of money and reputation for the besieged company. (Get the stuffed envelopes ready.)

A well-argued narrative for investor relations is really directed at a very small and knowledgeable audience of researchers and large funds, maybe a business program on TV. The goal is not to hype up a stock but to allow it to be priced for its fair value. While majority stockholders of listed companies may scoff at the cosmetics of communication (I know what my company is worth) some appreciation of the value of the narrative begins to sink in when the stock price is trapped in a 52-week low in the midst of a bull market. Maybe, it is the ego, and the grating realization that other less worthy companies are trading at premiums that spurs the insulated CEO to give financial communications a more serious look.

Anyway, the "theory of efficient markets" states that even if the market is uninformed, it is still right. Giving the market additional information can't bring a stock price any lower. Like good deeds, upbeat underlying numbers also need to be explained...lest they be punished by a PE ratio that is a third of the market average.

Even without embellishments, telling a story well should at least ensure a rapt audience...with deep pockets.

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