Communicating your equity story through and beyond the pandemic crisis

Thinking Ahead Post the Pandemic: Adopting a Modular Approach to your Investment Story to Succeed in the Competition for Capital

In recent weeks, the institutional investment community has been adopting a protective and defensive portfolio management strategy on the back of expectations of significant earnings downgrades, coupled with the risk of recession in the periods to come. Compared to other crises in recent memory, the current situation is likely to last for longer and will have a broader structural impact across the entire economic spectrum, with clear winners and losers. Issuers that understand and proactively address investor concerns will benefit in the inevitable battle for capital.

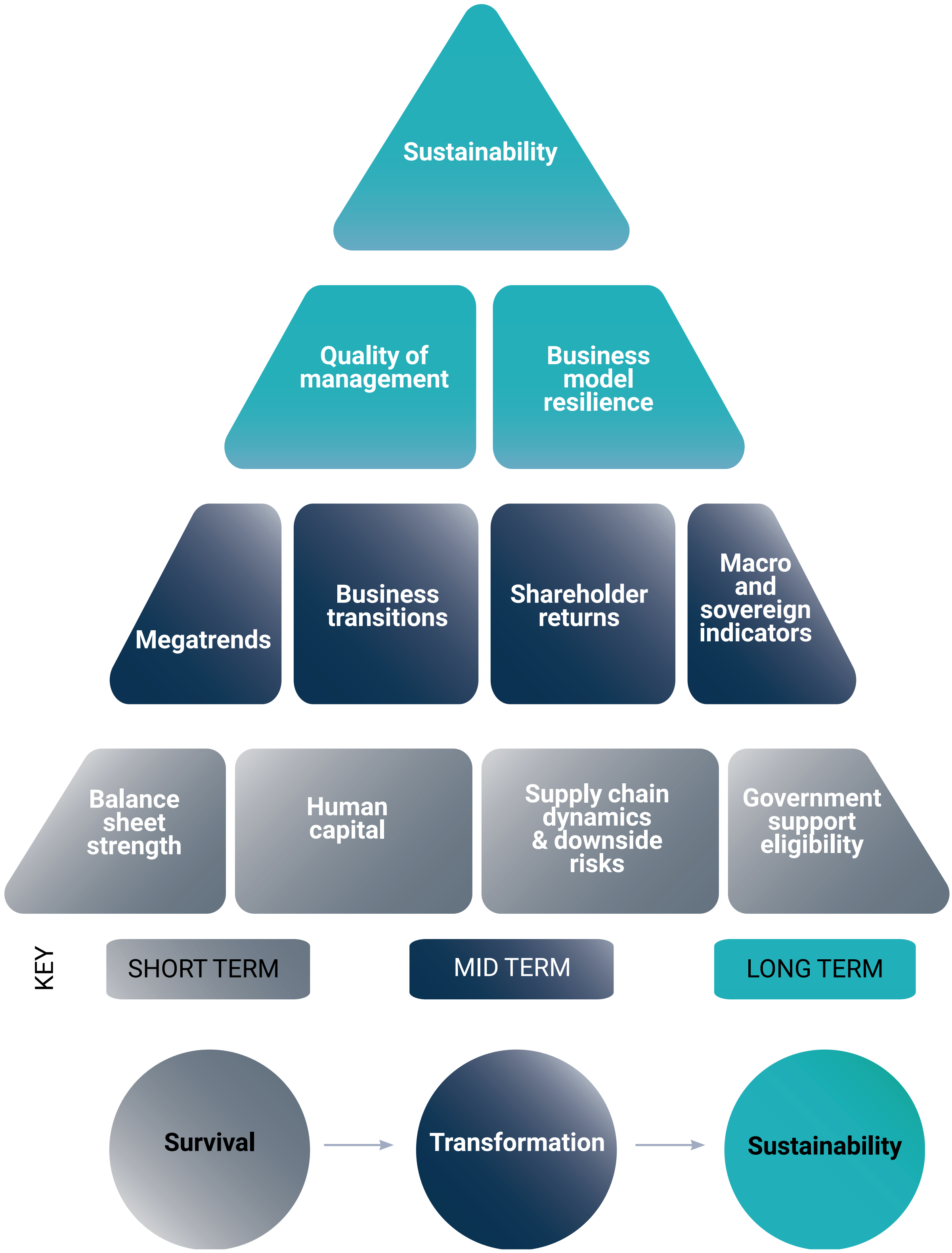
Whilst it is difficult to estimate a realistic timeframe for recovery, investors with a long investment horizon are already sizing up opportunities to enter into quality names which were trading at levels deemed unattractive in the past. Further to this, they are also naturally casting a particularly close eye on the sectors most affected by COVID-19, in order to ascertain the reasons for the dislocations affecting these stocks. In other words, whoever is harnessing the potential of alpha generation is currently trying to dissect the technical from the fundamental, to eliminate the least efficient models and to spot the most defensive and resilient ones. On the flip side, as consumer behaviour adjusts to the enforced lockdowns around much of the world, it will create opportunities for certain issuers, resulting in increased attention from investors.

To help investors in price discovery mode, as well as addressing the evolving questions of the existing investor base, it would be beneficial for IROs, Management and Boards to take a prospective stance on the inevitable shift in their investment story resulting from this unprecedented crisis. Some will argue that this is an impossible exercise at this stage, given the many variables linked to the spread of the disease, the government responses, global financial stimuli and a day-to-day assessment of the impact across the organisation on its employees, customers and all other stakeholders.

However, identifying the specific building blocks of the investment story which the markets will focus on at different stages of the crisis (spread, peak, flatten and normality) will be critical in carrying the investment community along. It will enable issuers to build a messaging framework that will be modular, easier to refine over time whilst maintaining consistency in the narrative, and ultimately more efficient in its dissemination. It will also illustrate how strategic priorities have shifted, crystallising the reallocation of resources in terms of future returns.

Whilst each sector has its own particular nuances, below are some considerations for these building blocks based on the focus of investors over the short, medium and long term as they assess their investment decisions. As with any exercise of this nature, it is difficult to put a strict timeline on what short, medium and even long term might be, as this will vary across industries and countries. Depending on the sources and assessment of the variables, a recovery is expected to take anywhere between 6 months to 2 years and it will be gradual, a dynamic which will consequently be mirrored by the investor focus on the various building blocks of the investment proposition.

Equity story building blocks



Short term: All eyes on balance sheet strength, human capital, supply chain dependencies and eligibility for government support.

As we have seen in recent communications from numerous issuers, the most prevalent concern for any corporate is its ability to weather the immediate effects triggered by the reduction or cessation of operations. As such, investor focus in the first instance is primarily around:

- The liquidity position and potential to access additional sources of cash, including expanding credit lines and, where relevant, exploring divestitures or joint ventures
- Measures taken in manage fixed and variable costs
- Levers for Free Cash Flow, such as working capital management and capex reallocation
- Foreseeable breach of covenants and level of flexibility from lenders

An additional, critical aspect is the ability for any corporate to run its operations and the impact on its employees. It will therefore be important to provide information around:

- Initiatives to ensure safety of employees and customers
- Support structures in place for impacted employees
- Ability to leverage IT and digital capabilities to ensure continuity of operations
- Business response and coverage of pandemic response

One of the unique aspects of this crisis has been the simultaneous shock on both the supply and demand side. In this respect, and in order to assess the downside risk, it will be paramount to outline the disruptions along the supply chain and address key elements such as:

- Geographical exposure and impact on supply and demand dynamics
- Impact on suppliers and, consequently, prices and costs
- Outline of natural or technical hedging capabilities
- Demand dynamics with a breakdown across products, distribution channels, etc.
- Potential disruption linked to changes in logistics channels
- View on which geographies might be poised to recovery faster than others

Globally synchronised and locally tailored policy responses can provide an immediate buffer to companies, but it will be critical to explain the remit and consequences of this support and address areas such as:

- Eligibility for external / government support
- Application across geographies
- Exonerations or postponements
- Pre-emptive conditions, such as suspension of dividends

Finally, a key validation point of the equity story is the financial guidance the Company provides and achieves, and, in recent weeks, issuers have been adopting a wide array of approaches, ranging from waiving guidance until further notice to providing a series of quantitative and qualitative scenarios. Given the unique situation we are in currently, allied to the multiple variables at play, we believe addressing the specific trigger points outlined above will help investors to gain enough visibility to develop their own models and, ultimately, manage consensus.

Medium term: Trigger points to encompass fundamentals, business transitions and drivers for shareholder returns in the possible absence of dividends and share buybacks.

After assessing the immediate response to the crisis, investor focus will gradually shift towards taking a more holistic view, beginning with the fundamentals to understand:

- Direction of macroeconomic indicators, e.g. oil price, currency movements, etc.
- Impact of country dynamics on the business fundamentals in the medium term
- Impact of financial, unemployment and fiscal stimuli domestically

Highly disruptive events across industries invariably trigger an acceleration or deceleration of underlying trends, and investors will want to understand how these transitions are managed and, critically, the impact on the business. Whilst themes will vary across sectors, the focus for many will be around:

- Change in Megatrends and lessons learnt
- Evolving consumer behaviour, such as buying 'local, domestic and nearby', greater focus on environmental sourcing and adjustments to marketing approaches
- Impact of digitalisation resulting in a shift in omnichannel and e-commerce strategies for retailers, increase in cashless transactions impacting financial services and greater online consultation for healthcare providers amongst others
- Ability to embrace technological advancements to enhance operational efficiencies

As conditions of regulatory intervention, it is possible dividends and share buybacks will be suspended for a period of time and investors will seek to understand how shareholder returns can be created in the absence of these. We have seen that, as a response to the crisis, companies are focusing on cash management, drivers to support profitability and efficiency and, more generally, looking at their investment priorities. This will continue into the medium term and hence investors will be looking at returns through the lens of:

- Operational efficiencies and productivity improvements
- Cost management
- Reallocation of resources and capex, alongside new business priorities and payback options
- Working capital management
- Portfolio pruning

One could also argue that, for highly leveraged companies, M&A activity will not be on the horizon, but with the price of certain assets having depreciated over time, this could create opportunities for strategic acquisitions or mergers. This could also be an important driver for returns for investors, especially were it to act as a catalyst for business transformation.

Long term: Building a sustainable ecosystem to strengthen the resilience of the business model.

Once the worst of the crisis is over and the pathways to recovery are clearer, companies will have to present their business models in a different light. Ultimately, it will be key to demonstrate their resilience to handle existential shocks in the future and address any structural changes in the industry such as:

- Changes in the competitive landscape
- Adjustments in revenue streams
- Shifts in market share and positioning

As evidenced in the aftermath of the 2008 financial crisis, there will also be greater focus from the markets on Management's and the Board's ability to respond to a crisis scenario. Whilst many companies have prepared for crisis scenarios, including pandemic response plans initiated by the SARS outbreak a few years ago, this is a distinctly unique - first time tested - situation given the breadth and scale of the impact. As such, increased focus will be placed around factors such as:

- Governance structures
- Contingency planning (scale, scope, synergies)
- Materiality of risk factors

Ultimately, it appears obvious that the current crisis will act as a catalyst to an even bigger focus on sustainability and good corporate citizenship. If the criticality of sustainability was not emphasised enough before the COVID-19 pandemic, then this crisis and its implications have made it crystal clear that this is one of the most important aspects of any business.

It is clear that investors will now devote greater time into assessing to what extent a company has set a sustainability focus – across all environmental, social and governance aspects – both to withstand downside risks but also as a driver towards a premium valuation.

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