Radnor View

Exiting Covid – A balancing act

19th April 2021

We have been hard at work, data-crunching during some quieter hours for this quarter's *Radnor View.* Recent conversations with investors have encouraged us to take a closer look at the post-Covid 'earnings recovery' and indeed what this could mean for corporates and their messaging.

After a period of significant unpredictability, we can say with relative certainty that companies will be competing within a very busy marketplace to project their growth aspirations and momentum into H2 and beyond. Many may feel they have a good story to communicate – but it is worth remembering that much of the market will also be feeling bushy-tailed as the world opens up (once again).

Demands on fund manager time will undoubtedly increase as physical meetings (remember them?) resume, whilst many corporates are already planning CMDs, strategy teach-ins, and in some cases, site visits. Overlay this with the UK's busiest IPO market for many years and we have ourselves a true bun fight. To put this into perspective, total funds raised in 2021 to date have reached £6.8bn, across 22 transactions, with more no doubt in the pipeline. By comparison, the average annual total for IPO funds raised over the past 10 years has been £8.2bn.

How does your message stack up against the competition? Is it time to sharpen things up…?

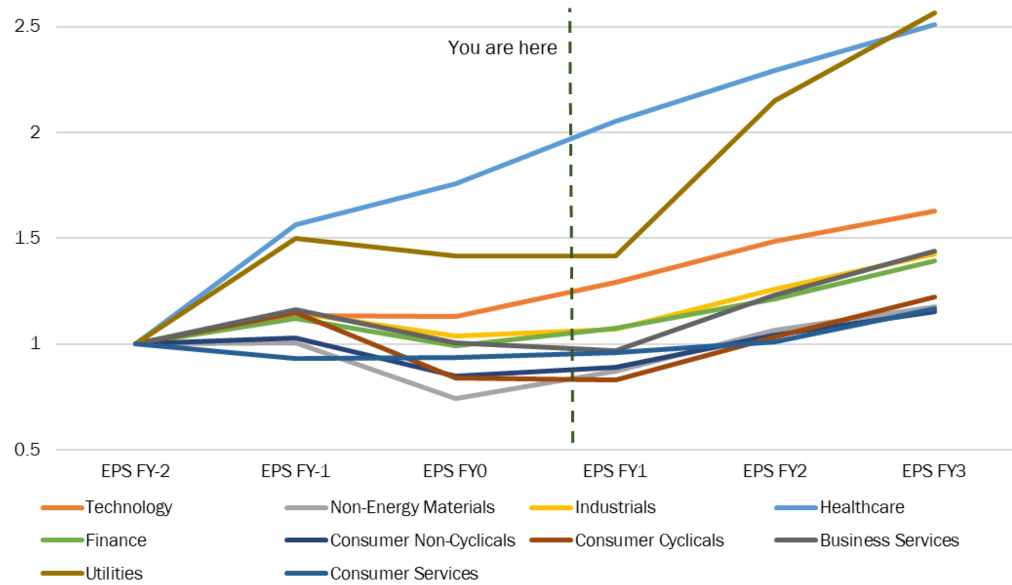
Most sectors will be in growth/recovery

Figure A below maps out the earnings projections for over 250 smaller (sub £2.5bn mkt cap) profitable companies, split by sector from two years pre-Covid (FY-2, actuals) through to year three post-Covid (FY3, estimates).

Figure B shows the same but excludes Healthcare and Utilities, in order to better show the range of other sectors.

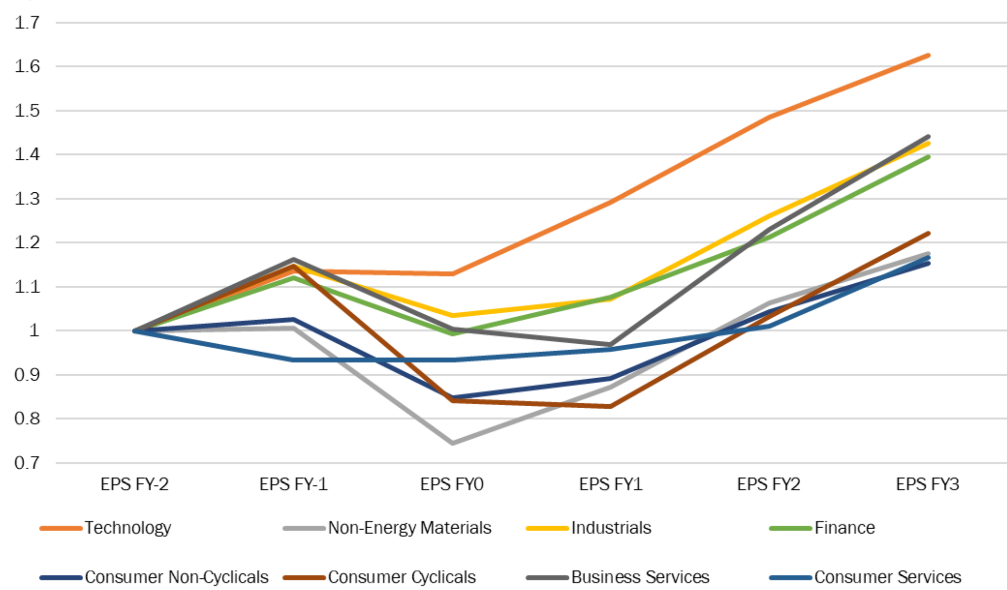
If consensus is accurate then nearly every sector should expect to see its constituents growing earnings over the coming two years. The averages are in fact remarkably consistent between sectors, generally at c.13% CAGR (FY0 – FY3). As can be seen in *Figure A,* Utilities are expected to record the fastest earnings growth (c.22% CAGR), possibly supported by the significant focus on renewable solutions.

Figure A – EPS evolution (FY-2 – FY3), all sectors



Source: Factset, Note: All EPS re-based to 1

Figure B – EPS evolution (FY-2 – FY3), excl. Healthcare/Utilities



Source: Factset, Note: All EPS re-based to 1

Differentiation will be key

To avoid being another face in the 'growth' crowd, companies will need to differentiate themselves, their equity story and messaging. Clearly this aspect is largely idiosyncratic to each business. However, more generally, potential areas could include:

- Has your company grown market share during the difficult Covid months?
- Is there the potential to accelerate earnings momentum via acquisitions?
- Do you have an improved margin outlook due to a leaner future cost base?

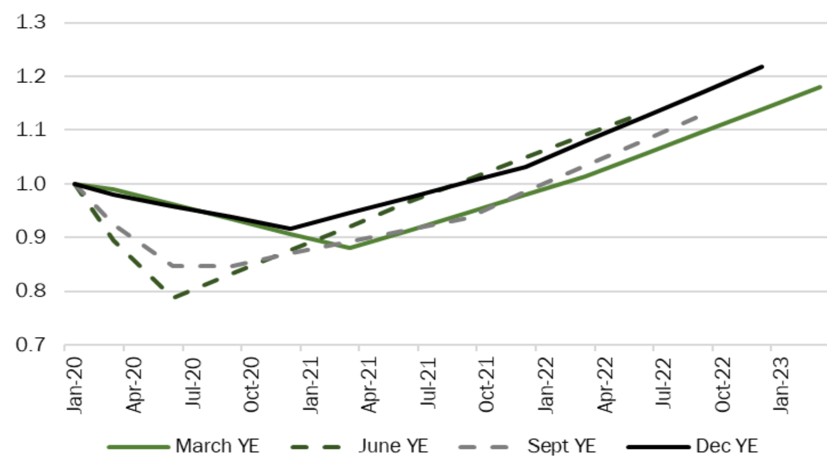
- Are you maximising the ESG opportunity – both from a messaging and commercial perspective?

Narrative will be arguably more important than the growth projections

Figure C below maps out the same data, but companies are now grouped by their year ends. As can be seen, an interesting trend emerges, demonstrating that **earnings forecasts are clearly influenced by the financial year end**, namely:

- Companies with **March and December year ends had the chance to 'recover' during their FY2020/21,** particularly after the significant impact from the first lockdown. On average, companies in these cohorts have experienced c.10% earnings decline (range is 8-12%) during Covid (FY2020 for Dec YE and FY2021 for Mar YE). Consensus currently has a c.33% earnings recovery over the two years from trough to peak (c.16% CAGR), to reach c.20% above pre-Covid levels;
- Conversely, those with **September and June year ends experienced a more profound impact to their FY2020 earnings outcome.** Therefore, the earnings profile was reset from a much lower base, with the recovery largely captured in FY2021. Optically, the recovery by these companies appears much stronger, relative to those companies with a March/December year end. Those with a June YE record 42% earnings growth from trough to peak over a two-year period (c.21% CAGR).

Figure C – earnings progression collated by the four main year ends



Source: Factset, Note: Excludes oils, miners, REITs and companies with negative earnings; All companies <£2.5bn market cap

What are the potential implications?

As noted above, almost all companies will be in a 'recovery' or 'growth' phase as the world normalises going forward. However, depending on where the year-end falls, the narrative could be very different ("resilience" or "rebound").

Whilst it may seem like a soft point, companies and management teams will need to understand and actively manage this dynamic when communicating the momentum story and engaging investors. Some peers will be starting from a lower base and will therefore be able to point to stronger earnings growth in the coming years. *Whilst a rising tide may lift all boats, not all the boats are the same.*

The converse also applies. With investors hoping for/expecting companies to make a strong rebound from the low point of 2020, many will feel under pressure to project an overly optimistic scenario in order to compete with peers. However, failing to deliver against these recovery forecasts could have more profound long-term consequences than the short-term benefits of being perceived as ‘high growth’. **Companies will therefore need to achieve the right balance of setting sensible growth/recovery projections coupled with a differentiated equity story that gets investors’ attention.** *Narrative will be key.*

Concluding thoughts

Perversely, as the world (hopefully) continues its path to normality, companies will be presented with new challenges in having their equity story heard. As always, the basics are highly applicable, but not always followed…

- **Managing narrative versus consensus.** It is easy to fall into the trap of guiding the market to a sustainable rate of momentum as we move out of extraordinary circumstances. Is this achievable? Remember, it is more important in the long run to set guidance appropriately and accumulate a track record of delivery. Take investors on a sustainable journey rather than going for easy wins.

  Track record of delivery = higher perceived quality = a better stock rating…

- **Preparing early.** Investor schedules will undoubtedly become more congested and bandwidth reduced. Preparation and differentiation will therefore be key. Management teams should be planning strategies, investor targeting and messaging now. Moreover, many of our conversations point to CMDs becoming more frequent later in H1 and into H2 – again, establishing an investor targeting framework from an early stage will be imperative to success.

  The early bird…

- **ESG messaging.** A theme gaining prominence by the day. Companies cannot construct an equity story, without this playing a major role. Ideally, a company’s ESG strategy and objectives should now be front and centre, with the commercial/growth aspects feeding off from the ESG core.

  There is more to an equity story than just the numbers in today’s world…

- **Remember, the onus is on you.** Corporates need to be proactive in their investor relations strategy. MiFID II and dwindling trading economics have made traditional investor engagement all but extinct from a broking perspective. It is therefore up to companies to ensure they have the right structure in place to maximise their position on the capital markets.

  Investors will not come <u>to</u> you….

For inquiries please contact:

William Game
Director, Radnor Capital Partners
+44 (0) 203 897 1834

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