



Governance challenges amidst the pandemic

Findings from the NZX 20 and lessons from Australia's
Myer case in providing earnings guidance

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Russell
McCaugh

As we move through the results and AGM season, boards of listed issuers have the unenviable decision to make as to whether to provide earnings guidance while the challenges and volatility associated with the economic effects of COVID-19 continue.

We have analysed the announcements made by the constituent members of the NZX 20 and summarised our findings below to provide an insight into current practices. We also reconsider the 2019 Australian Federal Court decision in *TPT Patrol v Myer*¹ in the context of providing practical considerations for boards of listed issuers in decisions on providing guidance to the market.

¹ *TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited* [2019] FCA 1747

Observations from the NZX 20

Our findings show:

Guidance in relation to expected FY21 earnings

- Around half of the constituents have provided guidance in relation to FY21 expected earnings, either as a specific expected Earnings Before Interest, Taxes, Depreciation, and Amortisation (EBITDA) amount or as a range.
- Others indicated that they would provide guidance at their shareholder meeting.
- A small number provided guidance on specific financial components such as expected cost implications from COVID-19 or results from investments, but not expected group earnings.

Assumptions and qualifications in forward looking statements

- Several of those companies providing guidance in relation to expected FY21 earnings have included assumptions and qualifications on their forward looking statements – including assuming that there are no material adverse changes, significant intervening events, changes to market conditions, meaningful further COVID-19 disruptions or unforeseen circumstances.

Dividend payments

- All but 3 of the index constituents have announced that they will pay a dividend or signalled a return to paying dividends.

Equity capital raisings

- Only 3 out of the 20 undertook equity capital raisings in the period since the first lockdown. This and their dividend positions appear to reflect the mature nature of their businesses and resilience of their balance sheets.

Gentailers

- Listed Gentailers have had to factor in the expected implications of the decision to close the Tiwai aluminium smelter.

Practical considerations and considering Australia's Myer case

Boards will need to continue to be vigilant on continuous disclosure during this period of heightened volatility and uncertainty. Keeping a contemporaneous record of continuous disclosure decisions is an important part of this – as is having a sound internal system for reporting matters up to the disclosure committee so that the issuer is able to consider all the information it ought to be aware of.

The decision to provide forward looking information in this sort of environment is naturally met with some apprehension. Any guidance provided – and equally a decision not to provide it – is clearly a matter that receives careful focus from analysts and institutional investors.

The Federal Court of Australia, in its 293-page decision on the *Myer case*, provides a number of useful principles for boards and issuers to consider in the decision to provide guidance.

The case, a class action brought by more than 1500 shareholders, involved allegations that Myer had breached its continuous disclosure obligations under the ASX Listing Rules and misled the market. The case concerned statements made by Myer's CEO at an analyst and institutional investor briefing that Myer's FY15 NPAT would exceed the previous year (despite the board having resolved that it would not provide guidance for FY15) and the lack of any subsequent corrective disclosure from Myer.

Some months later, Myer announced to the ASX that it expected its FY15 NPAT to be \$75m - \$80m (less than the previous year's FY14 NPAT of \$98.5 million) and its share price dropped by more than 10%. While the court found that Myer had breached its continuous disclosure obligations on several occasions and had misled its shareholders when it became apparent profit would be lower, this was not found to have caused shareholders any loss.

The decision is notable as the first Australian securities class action to have resulted in a judgment, rather than a settlement before trial.

While the decision pre-dates COVID-19, its principles are equally applicable in the current circumstances:

- **Statements of future matters to be based on reasonable grounds**

It is settled law in most common law jurisdictions, including New Zealand, that any representation as to future matters is not misleading if it is based on reasonable grounds. For directors considering forward guidance, “reasonable grounds” requires the directors to make a genuine assessment of the facts and whether they are capable of supporting the proposed guidance. In *Myer*, the quality of the budgeting or modelling process, the reasonableness of the assumptions, and the process of careful consideration of the board, were all relevant to the Court concluding that the guidance provided by the CEO was based on reasonable grounds.

- **Statements of future matters operate as continuing representations**

Once forecast information is provided, it is treated as a continuing representation and the maker is subject to a duty to correct it if the maker becomes aware that the information is incorrect. Performance should be monitored so that updated or corrective disclosure can be made if a material deviation (see below) becomes apparent. This was where *Myer* was found to be deficient.

- **Materiality**

For issuers that have provided guidance, if circumstances develop where a deviation of 5% or more is expected, this needs to be carefully considered for materiality. Deviations above 10% should be presumed to be material and the guidance updated – so as to ensure that the issuer’s conduct is not misleading or deceptive. The fact that analysts may (correctly) reach their own conclusions on the deviation in the absence of an announcement is not sufficient to support a proposition that the information is already generally available to the market for continuous disclosure purposes – although if that occurs, that may limit or reduce the quantum of damages due to there being less distortion of the share price (as was the situation in *Myer* where the Court found that the contraventions did not artificially inflate the share price because the market price already factored in an NPAT “well south” of the CEO’s “rosy picture”).

- **Consensus analysts**
Where an issuer has not provided guidance but analysts have published their own outlook on the issuer, once it becomes apparent to the issuer that its results will differ from analyst expectations the question is whether the difference in the issuer's own expectations is of such magnitude that, if it were announced, it would have a material effect on the share price.
- **Risks of de facto guidance**
Even if formal financial guidance is not provided, statements of general future outlook, such as anticipated growth in sales or net profit (without referring to specific amounts), can be taken as *de facto* earnings guidance and subject to the above considerations. Care should be taken on earnings calls and in investor meetings to ensure that information of this nature is only provided after a deliberate decision to do so and included in continuous disclosure.
- **Effect of disclaimers**
Even without the use of a disclaimer or qualifying statements, the Court recognised that forward looking information is subject to inherent uncertainties. Although the Court recognised that sophisticated investors would understand the qualifications associated with forward looking information (including express disclaimers in contemporaneous documents such as investor presentations released through the exchange) and that the wider business community usually would, a reasonable person would not regard a disclaimer as gutting the opinion or statement of meaningful content. While we continue to encourage the use of disclaimers, qualifications and assumptions where appropriate, this does not remove the need to monitor guidance going forward as a continuing representation.

Given the similarity between the relevant Australian law and rules and the equivalent conduct provisions in the Financial Markets Conduct Act 2013 and the NZX continuous disclosure rules, Myer clearly has relevant precedent value in a New Zealand listed issuer environment.

If the board has carefully considered the issuer's expected future performance and is satisfied with the underpinning information and assumptions, we expect that the board could reach a decision to provide guidance through this volatile period. Ranges, rather than specific figures, may well be helpful in this regard, and a wider range than usual implicitly conveys the greater uncertainty. Most importantly, care then needs to be taken to monitor ongoing performance and update the market as necessary if actual results will differ materially from guidance.

Overall, we consider that the market has developed well since the first few days of the pandemic when guidance was suspended almost across the board and issuers raising capital tended only to offer an outlook on their mid-term costs – and we hope the trend of returning to fulsome guidance continues.

Contributed by David Raudkivi and Kirsten Massey, with research provided by Anthony Yelavich.

Contact one of our experts

Please get in touch if you would like to discuss how this report's findings may be relevant and helpful to you and your organisation.

David Raudkivi

PARTNER - CORPORATE



EMAIL: david.raudkivi@russellmcveagh.com

DDI: +64 9 367 8344

Kirsten Massey

PARTNER - LITIGATION



EMAIL: kirsten.massey@russellmcveagh.com

DDI: +64 9 367 8893

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Russell McVeagh

AUCKLAND

Vero Centre
48 Shortland Street
PO Box 8, Auckland 1140
New Zealand

P +64 9 367 8000

WELLINGTON

NTT Tower
157 Lambton Quay,
PO Box 10-214, Wellington 6143
New Zealand

P +64 4 499 9555

For more information on the Russell McVeagh team and our recent work
please visit our website www.russellmcveagh.com