

Investor view

Insights from the investment community

Issue 6 - The role of the annual report

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The role of the annual report

From earnings releases to webcasts, from press briefings to websites, investors and analysts can access a wealth of information on most of today's leading companies at the click of a button. In this data rich, time-rich, time-poor environment, is there still a role for an annual document of record – the annual report? We asked a number of investment professionals.

Investment professionals tell us that the annual report is no longer viewed as the document of record that provides the cornerstone for all valuation work. But there appears to be little appetite for abandoning annual reports altogether. Instead, we hear a need for management to re-assess the annual report's role within the context of all their communication channels, and to consider more carefully the message that it conveys.

How the investment community uses the annual report

The annual report fulfils multiple roles within the capital markets, including:

Filling in the detail

Although the earnings release is typically thought to provide '95% of the data' sought by investment professionals, the annual report is still seen by many as a source for the detail that is invaluable in building a robust understanding of performance.

Getting up to speed

If investment professionals need to get to know a company, they typically turn to the annual report to provide background on the company's operations and historical performance.

A window on management

The annual report can play a role in reflecting the culture of the firm. Is there consistency in the messaging between the narrative and the audited financial statements? Do these messages fit with those found in the company's other channels of communication?

The way in which a company communicates – straight to the point, quirky or with 'spin' – is often assumed to reflect the culture of the company.

Just because it is there

Even if the report is never opened, just knowing that management has been through the discipline of pulling everything together in one place and has been subject to the challenge of the audit process provides comfort to the investment community.

Keeping the right company

A number of the investment professionals we talked to describe how the structure, tone and formatting of an annual report will have an impact on the type of investor that the company attracts.

Transparency and a balanced review of performance – when combined with consistency in the type of information presented over time – appeal to long-term investors. Traders, by contrast, will gravitate towards a company that is more opaque, as a lack of transparency allows an active 'rumour mill'. There is an expectation among those interviewed that such companies will suffer a cost-of-capital penalty.

How to improve the annual report

The quality of disclosure has improved in recent years. However there are still some areas in which investment professionals would like to see even more. For example:

Segments

The most commonly cited opportunity to improve reporting lies in the quality of the segment disclosure. Investment professionals are looking for a 'sensible' split of business, combined with sufficiently granular data for each segment – data that covers the income statement, balance sheet, cash flow and critical key performance indicators. Unless there has been a material shift in the business, consistency in the both the split of segments reported and the data line items presented is appreciated.

Coherency

Investment professionals look for coherent messaging between the narrative section of the annual report and the audited financial statements. They also expect a consistent message across all media channels.

We are told that separate sustainability reports can indicate that sustainability is not a core part of the business and so will not be valued by investors.

What drives performance?

There is a desire for management to make visible any material cost-drivers and the key sources of revenue. Investment professionals are keen to monitor the trends of these factors over time, preferably with historical data that covers an operating cycle.

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"Companies can either produce the annual report smartly, or they can produce it just because they have to. Those who do it smartly will positively impact their position in the capital market"

"I look to see if the report is 'businesslike' or a product of some expensive design team"

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