press releases

The Adoption of International Financial Reporting Standards: Who should lead the way?
Survey reveals equity market unprepared for IFRS changes

Leading investment banks are largely adopting a 'wait and see' approach towards the reconciliation of IFRS changes in financial modelling and forecasting.

A survey of 12 leading investment banks in London, published today by international financial and corporate communications consultancy Citigate Dewe Rogerson, in association with Fallon Stewart Limited, finds that most analysts are being left to decide for themselves how IFRS should affect their approach to company valuation. As a result, many are waiting for companies to offer guidance which, to date, has appeared on a piecemeal basis. The risk is that market valuations and share prices may be affected by a prolonged period of volatility while analysts lack consensus and a consistent approach to the interpretation of financial data under IFRS.

Key Findings

• Only two investment banks have provided a 'house view' for their analysts on the treatment of IFRS accounting standards in forecast models. The remainder are leaving adjustments to individual sector teams.

• Three-quarters of the investment banks surveyed have offered their analysts no formal training at all on the adoption of IFRS.

• Half of the analysts surveyed have not made any changes to their forecast models for companies, while a further 23% have only made partial changes.

• Almost a third of analysts have received no communication whatsoever from companies on the implications of IFRS. Less than 20% of analysts surveyed stated that companies had provided sufficient data.

• All agreed that the balance sheet and profit and loss account would be the financial statements most impacted by IFRS, thereby implying an increased focus on cash flows.

• Half stated that they would not be changing their valuation methods as a result of the adoption of IFRS, even though many responses highlighted potential impact on EV ratios, 'sum-of-the-parts' analysis and dividend payments.
Implications

• Potential for large variations in earnings forecasts – In the absence of widespread guidance for analysts, the likelihood of a broader range of 'normalised' earnings is considerable until the majority of companies report under the new standard.

• Detrimental effects on macro data offered by investment banks – The data that is used by investment banks to forecast market rates of growth is generally aggregated from analysts' models which, by their own admission, currently reflect only partial reconciliation with IFRS. Clearly, this has potentially negative implications for the validity of macro data offered by investment banks.

• Changes to underlying valuation metrics used in financial forecasting – While valuation methods are unlikely to change, the basis for valuations could alter materially. New treatments of pension fund positions and finance leases, for example, could create problems for companies valued using enterprise value ratios.

• Potential lack of consensus for small caps – Phased adoption for small cap versus large cap companies means that a twin track approach to valuation could emerge until smaller company accounting policies have caught up with their larger cap counterparts. Until they do so, it will be more difficult to derive meaningful small cap consensus estimates based on a mix of old and new reporting standards.

• Increased emphasis on cash flows – IFRS is likely to increase the emphasis on cash flows. While there has been a growing trend towards cash flow-based forecasting and valuation, it is by no means the dominant metric within analysis. By their nature, analysts’ cash flow forecasts tend to have wider ranges than those for P&L or balance sheet-based models. If the equity market increases focus on cash flow at the expense of earnings, consensus ranges could widen accordingly.

• Increased disclosure in preliminary announcements – Many analysts believed that it would be advantageous for companies to explain IFRS changes to the market at an early opportunity, for example in preliminary results announcements, rather than wait until the publication of final report and accounts.

Based on the survey findings, Citigate Dewe Rogerson concludes that companies need to do more to lead the way in communicating the impact of adopting IFRS.

Commenting on the survey, Scott Fulton of Fallon Stewart said,

“Our experience of forecast modelling suggests that companies wishing to communicate the implications of IFRS adoption must understand the framework in which the analysts work. It is insufficient to offer a static presentation of IFRS implications; companies must communicate how key metrics could move in the future. Furthermore, companies must continue developing their understanding of analyst valuation methods to efficiently present the impact of IFRS adoption on their accounts.”

Highlighting the key aspect of the research, Kate Delahunty of Citigate Dewe Rogerson commented,

“While the apparent lack of IFRS preparation within the sell-side is worrying, it is not an insurmountable problem. Indeed, our research suggests that it is not the technicalities of IFRS adoption that are holding analysts back, rather the level of communication from companies. Early dialogue on this basis will help the market adjust appropriately and avoid the volatility which has characterised recent announcements.”
-Ends-

To download the executive summary **click here**

For further information contact:

Kate Delahunty, Director
Citigate Dewe Rogerson
Direct Tel. +44 (0)20 7282 2934
www.citigatedewerogerson.co.uk

Scott Fulton, Director
Fallon Stewart Ltd
Direct Tel. +44 (0) 1525 634536
www.fallonstewart.co.uk

Notes to Editors

This survey was conducted by Citigate Dewe Rogerson, in association with Fallon Stewart Limited, during January 2005. It is based on telephone interviews with 30 investment analysts from 12 leading investment banks. These analysts cover companies within the banking, consumer products, natural resources, pharmaceuticals and telecommunications sectors, which together account for over 70% of the market capitalisation of the FTSE 100.

Citigate Dewe Rogerson

Citigate Dewe Rogerson is the leading international consultancy specialising exclusively in financial and corporate communications. Its works for clients, ranging from Fortune 500 companies to start-ups, focuses on developing and building corporate brands and actively managing reputations, notably with international capital markets but also with all other stakeholder groups. The combined strength of Citigate’s financial and corporate offering is unmatched by any other company. These skills are complemented by specialist services, including market research, broadcast and online.

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