AURORA
FUNDS MANAGEMENT

THE ALTERNATIVE VIEW

By Hugh Dive 24th July 2015

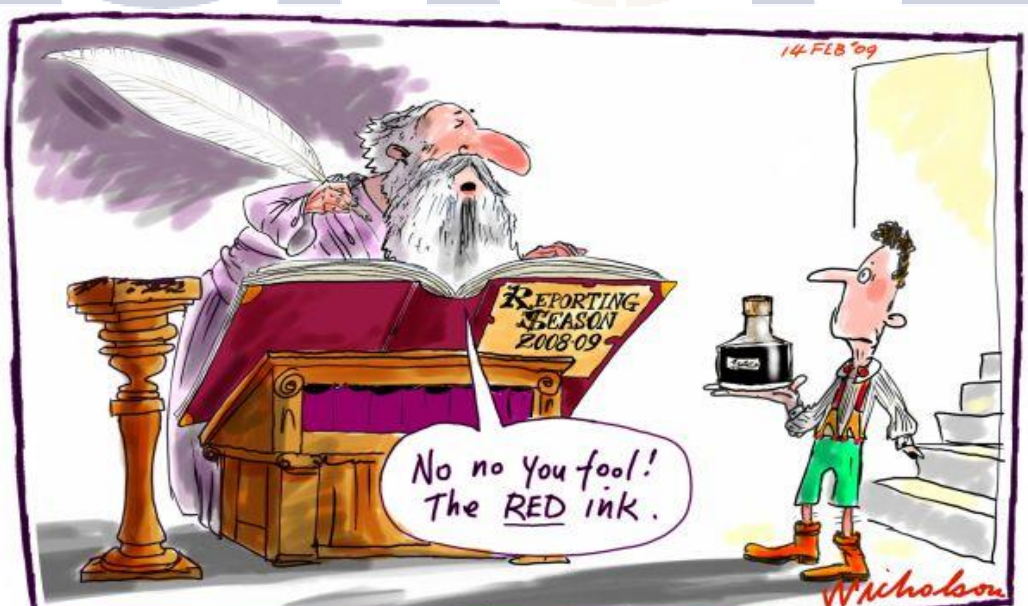
What goes on during Reporting Season?

For equity analysts in Australia Christmas comes twice a year, every February and August when the majority of Australian listed companies reveal their semi-annual profit results. At this time companies also provide guidance as to what growth in profit, revenue, profit margins or dividends that shareholders can expect over the following financial year. This can be a stressful time for a fund manager. When companies reveal unpleasant surprises, the company's stock price tends to get sold down hard. Alternatively, it can be very pleasant when the company reports a good result which validates the investment case for originally owning their shares.

In this piece we are going to go through how Aurora approaches each day during reporting season and what goes on during a typical day during the earnings season. It's not all convivial lunches with management teams in the boardroom of an investment bank overlooking Sydney harbor.

Before Reporting Season

In the lead up to reporting season Aurora reviews all the stocks in the portfolio and considers the key factors and financial metrics that investors will be looking for on results day and we compare our forecasts to the consensus analyst forecasts. What we are trying to do here is to identify which companies are performing ahead of expectations and more importantly which companies have the potential to disappoint. Whilst the Dividend Income Trust is unlikely to make significant changes straight after a company announces their results, Aurora's other funds seek to be positioned through either physical equity holdings or derivative positions to take advantage of corporate news flow that causes volatility in a stock price.



Source: Nicholson Cartoons

On the Day

Generally companies post their financial results with the ASX around 9am; this gives investors an hour to digest the facts and figures before trading on the stock exchange begins at 10am. During this period we will be combing through the profit and loss, balance sheet and cash flow statements comparing our forecasts to what the company actually delivered. Also it is important to compare how a company has performed against their peer group. For example, in isolation Westpac reporting a slight decline net interest margin (NIM) and modest lending growth could signal a great result if both ANZ and NAB have reported big declines in both categories.

In many cases company managements also give earnings guidance or an outlook statement which is dissected in minute detail, for changes in tone and language' much like students of Renaissance literature interpreting the meanings in Donne's Holy Sonnets. With some companies it can take a while to digest the finer details of the financial accounts. For example one year Suncorp's results had a surprisingly positive headline result with bold statements of "*good underlying result*" and "*upgrade its full year profit before tax and bad debts outlook to 10 - 12%, despite the impacts of the credit crunch*". Initially the stock was up 4%, but proceeded to fall 20% over the next week, as investors digested the result and became concerned about the company's capital position.

Company management will then formally present their results to shareholders on a conference call or in person during the morning generally between 9am and midday. These presentations are directed towards the institutional investment community and are effectively closed to the media and public. These meetings can take between one and two hours, as the management team gives greater detail on the factors that contributed to the profit result and explain any potentially contentious issues. The most informative part is always the Q&A session, which gives investors the opportunity to gauge how confident management are in tackling the more contentious issues coming out of their financial accounts. Typically it will only be the sell side analysts asking questions of management, with the large institutional investors saving their questions for behind closed doors. The problem with this is that in addition to writing research, some sell side analysts want to protect their relationship with the company and offer soft questions for the management or avoid the hard questions when the management has made some mistakes. This is where you will see agitated fund managers asking questions in a public forum, such as "*What comparative advantage does QBE have in writing Argentinian workers compensation insurance*?"

Lunch with the Company

After the results presentation we will generally have a quick discussion to see if there have been any fundamental changes to our thoughts and discuss the market reaction. The immediate market reaction can often be misleading, as most of the trading is being done by hedge funds or high frequency traders, rather than long-term fundamental investors. Most companies will hold a lunch for investors at one of the global investment banks, where invitation is based on the combination of how big an investor you are in the company and how much brokerage the fund manager pays that particular investment bank. These events are held in the boardroom of the bank and are fully catered events, though it is rare to see anybody accepting a glass of wine with their steak or fish. Many fine bottles of wine from the cellars of the investment banks get opened, offered around the table by waiters and then returned to the sideboard with one glass poured out.

Whilst this may seem to offer institutional investors an advantage over retail investors, it is rare that any new insight is gained in these events. This occurs as they are essentially a group meeting of rivals trying to understand what others think about the company and if you know the company well or have a particularly insightful question, an analyst will save that for a one on one meeting with the company. One year I attended a lunch with Fletcher Building at which the three largest shareholders (collectively owning close to 25% of the company) were present. As neither of these shareholders asked any questions, the lunch degenerated into Building Products 101, not a great use of precious time on results day. Often several large and complicated companies report on the same day, so unless an individual company has had a particularly good or bad result, it is poor time management to spend hours picking through the financial accounts of a company that has performed as expected.

Immediately Afterwards

Over the following weeks, the company will then organise individual one hour meetings with their largest institutional shareholders both in Australia and overseas. Prior to these meetings it is important to be well prepared, as this is frequently the best forum to understand whether you should buy more of a company's stock or completely sell out. During our meetings with the management teams, we will generally to seek clarity (on behalf of our investors) on certain issues that we feel weren't covered to our satisfaction at the formal presentation. Whilst some of these meetings can be quite hostile or very friendly, they are a valuable forum for both parties to give feedback on not only how our client's capital has been managed in the past, but also as to how that capital should be employed in the future. Several times I have been in these meetings where management has raised a potential strategy which seemed aggressive and quite alarming. By institutional investors signaling that they would be unlikely to support a course of action or capital raising, these companies saved investor's millions of dollars in investment banking fees!

After the management meetings and subsequent to reviewing the financial results of a company's competitors we are then in a position to determine what changes (if any) are made to our valuation of the company and whether the security's weight in the portfolio is still appropriate in light of competing investment opportunities.

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Aurora Funds Management Limited is a fully owned subsidiary of ASX listed, Keybridge Capital (ASX Code: KBC). Aurora is a boutique investment manager that was established in 2003, and has established a long track record of producing risk adjusted returns for retail, institutional and high net worth investors. The investment strategies are offered through both ASX listed investment vehicles and managed funds. They aim to deliver income whilst also managing the risks associated in investing in Australian and global equities.

Aurora is the issuer of the:

- **Aurora Dividend Income Trust (Managed Fund) (ASX code: AOD)**
- **Aurora Absolute Return Fund (ASX code: ABW)**
- **Aurora Fortitude Absolute Return Fund**
- **Aurora Global Income Trust (ASX code: AIB)**
- **Aurora Property Buy-Write Income Trust (ASX code: AUP)**

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