



PROFIT WARNINGS AND THE APPLICATION OF MAR– NASDAQ BOARD TALKS

On 20 March, the first seminar was held in Nasdaq’s newly introduced concept “board talks”, a forum for board directors of listed companies which is intended to contribute knowledge, frames of reference, and contacts which may be beneficial to them in their work in managing listed companies. The focus is on the rules and other conditions specific to listed companies, board work, and board of directors’ liability.

The first seminar addressed the subject of profit warnings and the application of the EU’s Market Abuse Regulation (“MAR”) in situations which might cause a company to issue a profit warning. Björn Kristiansson, an attorney at the law firm Kanter Advokatbyrå, opened the seminar with a presentation of the rules and overall issues. A panel also participated consisting of Brian Belanger, chief legal officer at Husqvarna, Annika Poutiainen, a director at a number of listed companies, and Björn Tibell, IR manager at SAS. Joakim Strid, former head of Surveillance at Nasdaq, was the moderator and prepared this brief summary. The interpretations and conclusions set forth below are those of the author himself and are not to be ascribed to any of the other participants at the seminar.

Definition and rules

There is no definition of what a profit warning is or what it entails. The concept is not referred to in MAR or the supplemental regulations and other guidelines issued in relation to MAR. Nasdaq’s Q&A regarding the issue of rules contains a question which addresses the concept, but this is largely the only reference to the notion at this time.

From a formal perspective, no such definition is required either. Put somewhat unartfully, as long as an issuer performs its obligations under MAR, it is of no significance whether a publication is classified or described as a “profit warning” or anything else. It is also very unusual that the concept is used in conjunction with disclosure of information by issuers. One can of course just as easily discuss how the MAR addresses situations which may give rise to profit warnings and how these fit in the context of the MAR, as was also done during the seminar.

It is common that listed companies, during the work in producing financial reports, take decisions to postpone the publication of insider information. In many cases, this regularly occurs a few days after the end of a reporting period when the issuer knows, based on previous experience, that the work involved in the financial accounts for the period has come to such an advanced stage that the information obtained can be deemed to constitute insider information.

A postponement of the publication presupposes that three conditions are fulfilled¹, one of which is that the postponement does not risk misleading the general public. In most situations where a profit warning must be published, it is a result of the fact that this condition has not been fulfilled. The issuer’s normal process for publication of the financial report must then be deviated from and information must be published at a point in time earlier than planned. Such early publication of financial information is the type of situation which, in day-to-day speech, is referred to as a profit warning.

The assessment of what might risk misleading the general public is a delicate task and took up a large part of the discussions during the seminar. As guidance, the rules only state that it may involve information which materially deviates from what the issuer had previously communicated regarding the same circumstances, information which relates to the issuer’s financial targets probably not being achieved, or information which contrasts with market expectations – if these are based on signals which the issuer itself has given to the market.

¹ Briefly, these conditions are 1) that an immediate publication would harm the legitimate interests of the issuer; 2) that a postponement does not risk misleading the general public; and 3) that the issuer is capable of keeping the information confidential until the time of publication.

The company's relationship with actors on the market

As is apparent above, there is no formal definition of what a profit warning is and the issuers themselves seldom or never use the concept. Consequently, one seldom encounters press releases containing the words "profit warning"; it is only in situations where another party, often journalists, have referred to information as a profit warning. This might give rise to conceptual confusion in situations where differing opinions prevail. The panel participants were able to present situations where their companies published information which was referred to by journalists as a profit warning despite the fact that the companies themselves had not regarded these in this way at all.

Even though there has been misunderstanding, the participants were in agreement that the issuers and the market are already in agreement as to what a profit warning is, and what should cause one.

A particular characteristic of profit warnings is that issuers must take into consideration the expectations of the market regarding their performance. This requires that the companies firstly monitor the forecasts or estimates of stock analysts. For larger companies, there is often plenty of information on which to base such conclusions, while for smaller companies it can be more difficult to obtain the relevant information.

One current challenge regarding analysts' estimates is that several producers of analyses have stated that they are no longer providing estimates to parties that compile and distribute such information. This might result in a lower quality of information for assessments of estimates, but the panel participants emphasized that, in all likelihood, the issuers themselves will have access to such information regardless of this trend which is now discernible.

Positions regarding possible profit warnings

The primary question which companies must regularly address is thus whether a decision regarding a postponement of the publication of information which involves the anticipated earnings might risk misleading the general public. In this assessment, it is necessary to form an opinion as to what the market expectations are. However, the rules prescribe that there is only liability for expectations to which the issuer itself has contributed and only these must be taken into consideration in conjunction with decisions regarding whether a postponement of publication can take place. It is therefore necessary to review the issuer's earlier publication of information together with signals which the issuer has otherwise sent out, for example statements in the media, investor meetings, and other channels.

Not all deviations from the issuer's earlier publication of information and market expectations require an immediate, separate publication in the form of a profit warning. Otherwise, profit warnings would probably be more the rule than an exception prior to the publication of financial reports.

There is no more specific guidance regarding which levels of deviation are relevant in the context. The assessment must proceed upon the basis of the company itself and its specific situation, where such factors as the issuer's business, the degree of historical variation in the earnings of the issuer and the industry, the state of the economy, and other factors must be weighed in.

Decisions regarding profit warnings and the handling of profit warnings

Different issuers have different methods for evaluating the state of information in general and profit warning situations in particular. There is no universal model but a conclusion from the panel discussion was that there is a clear benefit to being prepared, in part in light of the fact that the weighing of interests may be difficult and sensitive and in part taking into consideration the time pressure often involved in these situations. One of the panel participants stated that the controls of pending matters from an information disclosure perspective, and information disclosure issues in general, are handled by a specific insider committee, while others described how corresponding valuations take place when the need arises.

The generally prevailing opinion amongst the seminar participants was that a profit warning decision should be taken by the board of directors. However, it was stated that there is nonetheless often cause to delegate the decision-making so that urgent situations can also be handled.

For the exchange's part and in relation to the rules, the position is that ongoing disclosure of information in relation to MAR is a question for the operational management of the issuer and that, in ordinary situations, it is not required that the board of directors be convened in order for the company to be able to publish insider information. However, profit warning situations are different, by nature, to the extent that financial reports are adopted by the board of directors and it may therefore be considered reasonable that early publication of such, or extracts from them should also be handled by the board of directors. Employing an effective procedure for evaluation of the information which is collected during the reporting work and convening the board of directors where there are early signals regarding deviations, should make it possible for profit warnings to be handled by the board of directors without any time delay as compared with if the situation had instead been handled by corporate management.

One particular problem which was addressed was that profit warnings decisions may be complex and may contain components which the board of directors should naturally be involved in, for example decisions regarding write-downs of assets. In certain situations, for obvious reasons, it will therefore be necessary to convene the board of directors for a decision regarding a possible profit warning. This entails that directors, particularly during the reporting work, should be prepared to be called in on short notice to take such positions. There should also be preparedness, and an acceptance, that such meetings and decisions will be handled without the participation of all of the directors. When decisions regarding profit warnings are taken, there is no longer the possibility to postpone the publication of the information and, according to the main rule in MAR, this must take place as soon as possible.

The interpretation of "as soon as possible" led to a great deal of discussion during the seminar, even if the question is not specific to profit warnings. A basic condition is that, within the scope of "as soon as possible", there must be time to both clarify the information situation and to make the actual publication. How much time is required depends on the individual situation and the conditions for the relevant preparations. However, it is important that the issuer ensure that the time delay be limited to what is required to be able to make the insider information public, not other work or time needed to create a message around, or a context for, the information.

In closing

Profit warning situations continue to be a challenge and difficult for issuers to handle. To some extent, MAR has changed the conditions for these situations even if the problem basically remains unchanged and profit warnings take place in the same situations as previously. As is often emphasized, MAR imposes general requirements on structure and discipline. One general piece of advice is to allow this structure and discipline to work for the company and to contribute to robust procedures and documentation routines which should ultimately reduce the risk of any regulatory violations. By discussing scenarios which might lead to profit warnings and preparing prior to these, a good foundation is also created for handling difficult information situations in a correct way.

The seminar offered particularly interesting and passionate discussions and we would like to thank all of the participants who helped to create the very type of exchange of opinions 'board talks' was intended for!