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Views from the Japan Equities Small Cap Desk

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"…companies under harsh conditions tend to release over-optimistic guidance"

How to assess earnings guidance for the FY2020

A large number of companies, including retailers and distributors, announced their financial results for the fiscal year ending March-May quarter. Some companies that refrained from releasing earnings forecasts for the FY2020 three months ago, such as Shimamura (8237) and Lawson (2651), released them this time. Of the companies that ended their fiscal year as at the end of February or March, 45% announced sales or earnings guidance as of 13 July. The ratio is three points higher than the ones announced as at the end of May but a majority of them still cannot predict their corporate performance.

Under these circumstances, the summer issue of the Japan Company Handbook 2020 was issued one week later than usual. At least, now we can find estimates of earnings forecasts of all listed companies in the handbook including small and mid-cap stocks that are not covered by sell-side analysts. It seems stock markets are generally responding in a straightforward manner to the estimation of future earnings, with no other option for investors amid the ongoing uncertainty over the future.

Now that we have a rough idea of the earnings forecasts, the next thing to do is to examine their accuracy. I believe there are big investment opportunities in the markets and we can grasp them by reviewing assumptions and stances on figures of each forecast and getting a clear handle on each forecast.

I think some companies are too optimistic about their future given their tough business environment. Given that companies under harsh conditions tend to release over-optimistic guidance, we should stay away from these companies.

Conversely, companies that benefited from special demand are likely to raise their forecasts. For example, retailers that sell daily necessities such as grocery stores and DIY home centers are supposed to book a record profit for the March-May quarter thanks not only to hoarding and changes in lifestyle among consumers but also restraint on discounts and sales promotion for their part. While consumers will stop stockpiling and strategic marketing costs are expected to increase in the June-August quarter as the competitive environment returns, we still expect they will achieve sharp earnings growths for the FY2020,

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That said, we have to take into consideration the balance between stock prices and mid-term prospects to figure out the timing of investment. Stock prices of these beneficiaries are already far from cheap in terms of past earnings as most of them rose sharply from this April on the back of strong monthly sales. Investors now have to weigh up whether their strength comes from short-term special demand or long-term changes in lifestyle.

I personally feel there are a lot of attractive investment destinations in stocks that have been sold off on the grounds of announcements of slight earnings declines. While I said that the market response to earnings forecasts was straightforward, I have an impression that it was particularly punitive against projections of earnings decline.

Of course, some forecasts look extremely upbeat, but some other companies with businesses that can maintain high earnings even under the tough environment are likely to dodge sharp earnings declines and meet their conservative targets. If these companies achieve earnings growths for the current FY, their stocks are likely to move up further.

If you are a risk-tolerant investor, it might be interesting to buy stocks whose earnings seem to have hit bottom under a tough environment. For example, wedding hall operators that are expected to run big losses across the board in the first half of FY2020, according to the latest Japan Company Handbook. While almost all of the bookings for wedding ceremonies up to this August were pushed back due to the coronavirus outbreak, orders from this September to the first half of the next year are increasing instead of decreasing. They may recoup lost ground in the second half or after as long as there is no resurgence of the coronavirus.

The next big event is the earnings announcement season for the April-June quarter, starting from the end of July. Many companies with a fiscal year ending 31 March are likely to start releasing their own guidance again, so that we will be able to have a clearer picture on corporate earnings of this FY. But as I said before, we should put more emphasis on earnings results for the next FY or after.

Source: Based on article by Tatsuro NIGAURI, published in The Nikkei Online Edition on 17 July 2020

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Tatsuro Nigauri is a Japanese small-cap equities manager with three decades of experience managing money based in Tokyo. He joined the firm in Oct 2002 and has managed the Japan Equity Small Cap Absolute Value strategy since its inception in 2004 and the UCITS funds since their launch in 2017. He started his career as a research analyst at the Daiwa Institute of Research in 1991. Nigauri is an award-winning manager and has received many accolades, including the Lipper Fund Awards Japan (2012, 2013 and 2016), the R&I (Rating and Investment Information) Fund Awards (consecutive years from 2012-2019) and the J Money Fund Awards (2016 and 2017).
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