This article first appeared in *Reporting*: ey.com/reporting

What investors want to know about financial businesses

Patrick Lemmens of Robeco tells *Tim Cooper* that investors in financial companies look beyond the accounting data to focus on capital and cash flow.

Many global financial firms do not disclose enough useful information for investors in their annual and quarterly statements, according to Patrick Lemmens, an Executive Director at Robeco, where he manages the New World Financials fund.

Lemmens says that, while some companies are improving, many are too focused on profit accounting rather than providing more pertinent data about capital and cash flows. The ability to generate cash flow is particularly important for young financial companies such as FinTechs.

"We need to look beyond the accounting data. Increasingly, we are analyzing cash flow data and levels of capital rather than profit in the accounting model," Lemmens explains. "Accounting rules such as IFRS 9 – which requires you to provision amounts you expect to lose from a loan in future today – are very cautious, as you are provisioning for something that might not happen. Rules such as these create more short-term share price volatility than necessary.

"Also, for us, it is better to look at long-term trajectory rather than at every quarter of data; we try to anticipate how the company will be performing in two years. That's because you can have a disappointment in one quarter, so we try not to read too much into that."

Markets are too reactive to such short-term disappointments, says Lemmens, but this creates opportunities. "We might use that shorter-term volatility to change positions as the company overshoots or undershoots expectations. So, we are looking for things that might drive the stock price for a short time, but then it will revert to fundamentals."

Geographical differences

Some financial companies are getting better at providing detailed cash flow data, Lemmens continues, as they are increasingly aware of what investors need and they want to help. Others still spend too much time on regulatory accounting data because they believe shareholders and the market look at that.

There are some geographical differences, too. "UK financials such as insurance companies have been relatively prompt in providing more information on their cash flow position and how it's developing," he says. "Many such companies around the world are doing the same. However, US companies tend to be more traditional, and [stick more to] GAAP.

"We push companies to provide cash flow data; some do it, some don't. If they don't, it means we have to do it ourselves by taking out the non-cash items and conducting an economic value-added analysis," Lemmens explains. "The problem with this is that we may have to make adjustments and end up with an approximation.

"For example, with commercial and corporate banks, cash flows cross over and intermingle between cash in the business and customers' money. This can make it complex and difficult to get a feeling for the exact flows. Insurance companies are generally easier to analyze in this respect, and technology companies easier still."

Tangible data

All this means that Lemmens focuses less on annual reports and quarterly releases and more on presentations from the company, usually posted in the investor relations section of their website. This might be a slideshow or a recording or video of a presentation to analysts, which often gives more relevant detail.

"Also, we get a fuller indication of longer-term performance from meeting and talking to the company about their plans," he says. "When we meet with companies, we cover a range of questions to see whether their growth and development are in line with their long-term plan and with market expectations."

Another problem in this sector is that banks are forced by regulators to provide too much data, says Lemmens. "The amount of data and disclosure since the financial crisis has increased to the point where they are swamping us – there is too much available and it is too detailed.

"I would like [companies to focus on providing] more tangible data that is relevant to me today. What is your capital position today? What is the cash position? What dividends are you paying? How are you deploying your cash – for example, how much are you reinvesting and where? Those things are more important than a manipulated earnings number that has many assumptions behind it and so is not tangible. For example, if you hold a bond, you keep it to maturity – you are not going to sell it today, so it is meaningless to value investments based on today's value."

A new world of reporting

The global shift from GAAP toward IFRS has allowed better comparison between countries, Lemmens adds, "but we still have to make many adjustments. Focusing on capital, cash, reinvestment and dividends helps to break through all that. But local demands on capital and the regulatory demands on banks and insurance companies are relevant, so you have to look at these issues locally as well.

"Some countries have made progress in providing good data. Others are at an earlier stage. Generally, they understand that having internationally recognized accounting systems will encourage investment." ■

March 2019

> "We need to look beyond the accounting data. We are analyzing cash flow data and levels of capital rather than profit in the accounting model.

Patrick Lemmens: Profile

Patrick Lemmens leads a team of three who manage the financial funds at Robeco, a global asset manager based in Rotterdam in the Netherlands and owned by Japanese company ORIX. Robeco has €171b (approx. US$195b) under management and 890 staff in 15 offices worldwide. In addition to fixed income and mainstream equity investments, it runs funds that focus on trends. These include two on financial trends: Robeco New World Financials, with €826m (approx. US$944m) under management, and Robeco Global Fintech Equity, with €703m (approx. US$804m). Lemmens has been managing investments in this sector for 15 years and has been the lead manager on the Robeco New World Financials fund since 2008.

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About *Reporting*
Reporting, EY Assurance's insights hub, brings together insights and ideas that will interest, inform and inspire business leaders. It's about more than the numbers, examining reporting in its broadest sense.

Our content is tailored for board members, audit committee chairs and finance directors of global companies. For more information, visit ey.com/reporting.

EYG no. 001331-19Gbl
ED 0320

ey.com

Building a better working world