The Profit Warning Survival Guide

Lessons learned from 245 small cap disasters

Stockopedia

The Profit Warning Survival Guide

Lessons learned from 245 small cap disasters

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This book would not have been possible without the tireless efforts of Paul Scott - the prolific writer of the UK Small Cap Value Report at Stockopedia.com. With an average of more than 4 reports per week and more than 40,000 words written per month his work has been a treasure trove to mine for profit warning reports. I think we speak for tens of thousands of small cap investors when we say "Thanks Paul!".

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Introduction

There are very few events in the stock market that cause as much concern and confusion as **profit warnings**. Reports of an earnings 'miss', a slump in trading or an unexpected setback, are naturally loathed by the market. These gut-wrenching events tend to be punished with instant and savage falls in stock prices. Shareholders caught in these situations face the emotional turmoil of sudden losses and the agonising decision of what to do next.

One of the defining features of profit warnings is that they're shrouded in market myths, which only add to the sense of confusion. For some, profit warnings are "an ideal buying opportunity", while others believe they "come in threes". Some use them as "an opportunity to average down" while others don't dare "catch a falling knife".

In **The Profit Warning Survival Guide**, the team at Stockopedia.com have set out to definitively answer the question of what to do in a profit warning. While most investors hang their decision making on gut instinct or a subjective analysis of the underlying business story, we've taken a long, hard, rational look at the statistics.

By conducting an analysis of hundreds of smaller company profit warnings over a three-year period between 2013 and 2016 we've constructed a data set that has few peers in international research. From the data we've set out to answer several questions including:

- How far do stocks fall on a profit warning ?
- If a stock suffers a profit warning, is it likely to recover ?
- Should you buy or sell on a profit warning ?
- Is there any way to avoid profit warnings ?

- Which sectors are most hit by profit warnings ?
- Do profit warnings over-react and thus bounce ?

The goals of our research project were to uncover the facts, debunk the myths and offer a clear statistically guided pathway for investors to make more optimal investment decisions.

Not only do our findings validate the results of many academic studies in this field but provide a unique insight into the behaviour of smaller company investors on bad news. We hope these insights will help you sidestep many of the emotional snares that entrap both individual and institutional investors alike, and lead you on the path towards more profitable decisions.

Using this Guide

If you are in a hurry and want to jump straight to the key findings from our study look out for two things: Firstly, remember that a picture is worth a thousand words. The findings of our research are best understood by looking at the charts & graphs. Secondly, the key actionable ideas from the research are broken out into asides next to this key symbol at the end of each chapter.

The Research Project

A research team at Stockopedia.com's HQ in Oxford carried out an investigation in the summer of 2016 with the goal of building a profit warning database. The initial source of data on profit warnings was *'Paul Scott's Small Cap Value Report'*[1] - a column produced by the prolific UK Small Cap Analyst, **Paul Scott**.

Paul Scott writes up to 5,000 words daily, analysing company news in the UK small cap segment from an investor's perspective. There are around 500 shares covered in Paul's small cap universe, which incorporates more than 25% of the UK stock market. As small caps tend to be a very popular hunting ground for individual investors, the scope of this study is particularly relevant.

Paul Scott

A search of Paul Scott's reports was backed up with a further search of London Stock Exchange "Regulatory News Announcements" for the essential profit warning keywords mentioned in the next section.

The team found **245** profit warnings between **January 2013 and early August 2016**. Every instance of a profit warning in the reports during the period was cross-checked with the original news announcement to confirm its veracity and precise date. As many profit warnings are reported after the close of trading or at the end of a week, the team compiled the next "price impact" date for each event.

To put the research into context, the period under review saw relatively benign stock market conditions. The biggest dips during the period included short-lived sell offs in October 2014, January

[1]http://www.stockopedia.com/smallcaps/

2016, and following the EU referendum in the summer of 2016. Overall, though, the more than three and a half year period saw the FTSE All-Share rise by 12.5%. As such, the sample was taken during a period of mostly sideways market performance.

Building a database

The data was gathered, filtered and organised before being used to query Stockopedia.com's extensive stock market data.

- **Historic & Intraday Prices** - were queried to calculate the price performance of each stock both before, during and after the date of price impact after the profit warning. We hoped to construct a model of the average profit warning to understand its 'anatomy'.
- **Fundamental & Technical Archives** - were queried to understand the 'traits' of each stock before and after the profit warning. In particular we analysed the relative Quality, Value and Momentum of each share using the Stockopedia StockRanks - a share ranking framework that has historically proven effective explaining stock market returns.

An important feature of the sample was that it consisted mostly (though not exclusively) of smaller UK quoted companies. This data is useful for the following reasons:

- Firstly, smaller companies can be prone to **unpredictable changes of fortune** in their financial and operational health, which can lead to profit warnings. Sudden firm-specific deterioration is arguably much harder to predict in smaller companies than it is in larger companies. As such, the sample provides a useful insight into how the prices of small-caps react to profit warnings.

- Secondly, small-caps are an area of the market that enjoy **far less research coverage that larger companies**. This makes it difficult for investors to fully understand their resilience to operational downturns and their ability to recover from them. This lack of professional analysis magnifies the uncertainty of profit warnings and arguably leaves investors much more in the dark when they occur.
- Small-cap stocks also have a **large following among individual investors**. So studying the impact of profit warnings in this segment of the market provides useful insight for investors who would benefit from understanding how to respond to them.

How to spot a profit warning

Security Analysts at professional brokerage firms create models to forecast the profits for most listed stocks. These forecasts tend to set the expectations of the market and thus the valuations of stocks. A company "warns on profits" when it realises that the consensus forecasts of the investor community are too high and wants the market to recalibrate expectations.

For unsuspecting investors, the first inkling of a profit warning may be the sight of a share price in free fall, and a savage price drop normally points to only one thing… bad news. Profit warnings may be due to a number of reasons including lost sales, missed contracts, supply chain issues or macro-economic reasons. Learning to gauge the severity of the news may require decoding the management phraseology used in the announcement. Before we try it's worth clarifying a couple of points.

Firstly, it would be unfair to suggest that companies like to sneak out profit warnings. Most appear to be up-front when things have gone wrong. But that's not to say that bad news can't be buried, window-dressed, under-emphasised or left to the very last sentence of a press release. Indeed, many profit warnings initially sound very upbeat, only to be let down by one or two killer sentences.

In addition, some companies choose to issue their bad news mid-way through the trading day or, worse still, after the market closes. These efforts tend to be counter-productive in terms of protecting share prices and may also serve to irritate investors even more.

Profit warning bingo

Armed with the knowledge that profit warnings can be glossed over, here are some crucial management phrases to look out for…

"Broadly in line with expectations"

The number-one takeaway from financial results and trading updates is whether a company is missing, meeting or exceeding the expectations that have been set by the management and analysts. *"Broadly in line"* has earned itself the reputation as a very British term that fudges the facts. Paul Scott's rule-of-thumb is that *"broadly in line with expectations"* is management speak that really means *"a bit below expectations"*.

In February 2016, health services company Cambian issued a profit warning[2], which included the following explanation:

> "Since the previous announcement, revenues and wages have been ***broadly in line with expectations***, but due to weaknesses in our cost management processes, it took longer to identify and manage down other costs."

Shares in Cambian fell by 52% on the day of this profit warning.

"Below current market forecasts"

As the name suggests, market forecasts - or market expectations - are the targets set by the consensus of analysts, rather than the company itself. But management often have close ties with analysts and help them formulate the assumptions in their models.

[2]http://www.stockopedia.com/share-prices/cambian-LON:CMBN/news/rns/160209cmbn4714o.htm

So the consensus view of analysts can be a strong reflection of the company's own expectations, too. As such, missing current market forecasts is a declaration of failure.

In January 2013, engineering group Chamberlin issued a profit warning[3] which included the following line:

> "The board expects that the group will deliver pre-tax profits **below current market forecasts** for the full year."

Shares in Chamberlin fell by 20% on this announcement.

Of course, there are degrees of severity in missing market forecasts. So on spotting this line, it's important to figure out how serious the forecast 'miss' is likely to be…

Severe warnings

Profit warnings fall into two broad categories: severe and mild. Paul Scott describes severe warnings as those where profits will be below previous expectations by a wide margin. In these cases, you tend to see terminology like 'materially below' or 'significantly below'.

In a profit warning[4] in January 2016, oilfield services company Plexus Holdings, reported:

> "As a result of this, the company's financial results for the year to 30 June 2016, which are subject to external audit, will be **very significantly below market expectations**."

Shares in Plexus fell by 44% on the day of this announcement.

[3] http://www.stockopedia.com/share-prices/chamberlin-LON:CMH/news/rns/130128cmh4572w.htm/?title=trading-statement

[4] http://www.stockopedia.com/share-prices/plexus-holdings-LON:POS/news/rns/160125pos8281m.htm/

Mild warnings

In contrast to severe profit warnings, a mild earnings miss may not be as severely punished by the market. Again, the implication is that the company will miss previous expectations by a small margin. In these statements, expect to see phraseology like 'slightly' below expectations.

In November 2015, marketing firm Communisis issued a mild profit warning[5] with the following comment:

> "The group expects to deliver results for 2015 that reflect double-digit growth in adjusted operating profit… but **slightly below previous expectations**."

Shares in Communisis fell by 14% on this announcement.

[5]http://www.stockopedia.com/share-prices/communisis-LON:CMS/news/rns/151112cms4168f.htm/

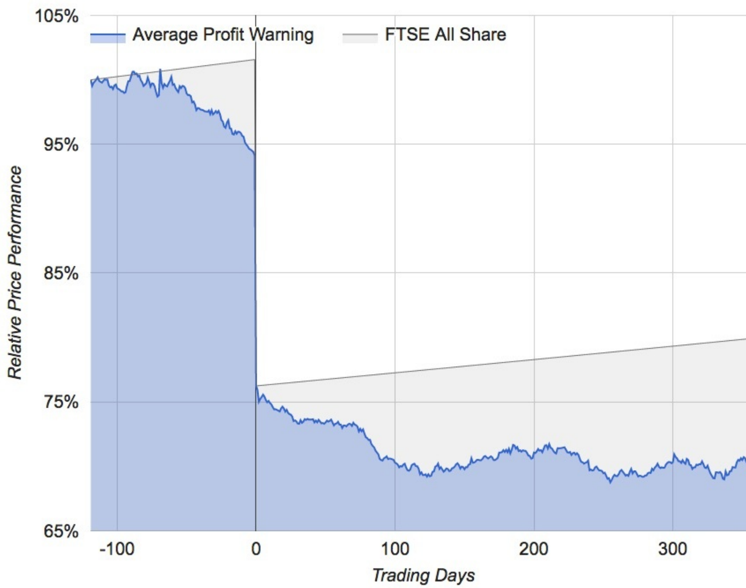
The Anatomy of a Profit Warning

By combining the price histories before, during and after each profit warning we built a model of the average price performance of a profit warning stock. Initially we looked at the week before a profit warning up to three months after, but the analysis was so startling that we had to push our timeframes out on both sides. It was only then that we could understand the full, complete picture.

While the majority of the drama happens on the day of the profit warning itself, the true story unfolds over a two year period. It starts 120 trading days (almost 6 months) before the event and continues to unfold over the next 360 trading days (almost 18 months) after the event. This creates a stunning visual picture we're calling **The Anatomy of a Profit Warning**.

The Complete Journey

Before we talk you through the journey, section by section, here's a chart of the average profit warning decline in all its glory. If there's one thing to remember from this Guide, this is it. We recommend burning this image into memory.



The Average Profit Warning Fall vs the Market Index

Key to the Chart

- The horizontal axis shows the number of trading days before and after the date of the profit warning (day 0).

- The vertical axis shows the price performance as a percentage of the starting value at a date 120 days before the profit warning.
- The blue line and area signifies the price performance of the average profit warning.
- The grey line denotes the return of the market average (FTSE All Share) over this timeframe expressed as a straight line. The grey area signifies the opportunity lost by holding onto a profit warning stock.

NB - we used the first 135 profit warnings in our database in this chart study to ensure 18 months of ensuing price history.

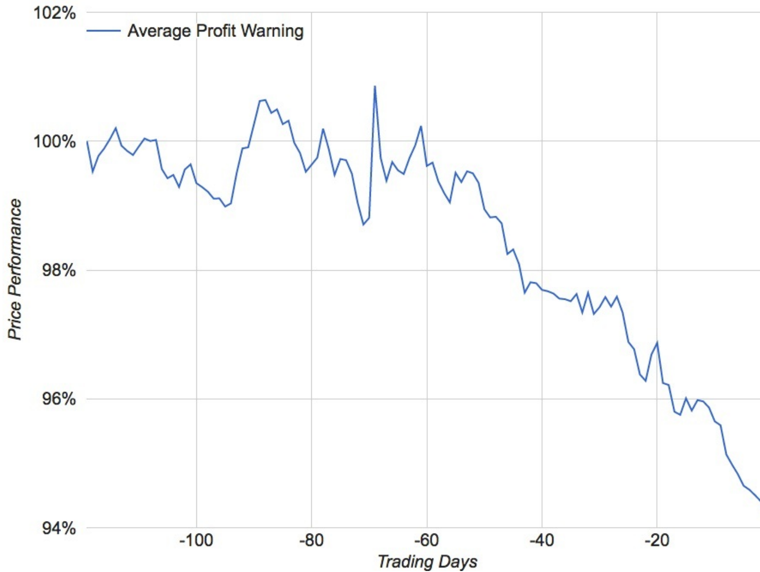
Key Results

- On average, **prices begin falling** by 6% in the 6 months before the warning.
- The **average price decline on the day** of the profit warning was -19.2%.
- A noticeable further decline followed for two to three months after the warning, possibly coinciding with further earnings news.
- Over 12 months later there was, on average, **no significant reversal** in the price decline.

Six months before - the Accelerating Decline

Contrary to popular opinion, profit warnings begin up to six months before the actual news announcement. From the following close

up we can see a continued, and accelerating decline in the months before the event.



Average performance in the preceding 120 trading days

Our study suggests the typical stock declines by an absolute 6% during this period, which is a relative underperformance versus the benchmark of 7.6%.

There may be a couple of explanations for this phenomenon:

1. The stock's fundamentals and its industry group may have already started declining before the announcement.
2. Company insiders (directors or other individuals close to the company) may have leaked information to analysts or to other institutional investors.

Whatever the reasoning behind the accelerating decline, one of the key leading indicators of a profit warning is poor share price momentum, and accelerating declines in the fortnight before.

Announcement day - the Crash!

The real sucker punch of a profit warning happens on the day of the announcement - with more than 60% of the overall 2 year decline happening in a single day. Psychologically it's a huge test not only for the shareholders who currently hold, but also the bargain hunters sniffing out a cheap new holding.

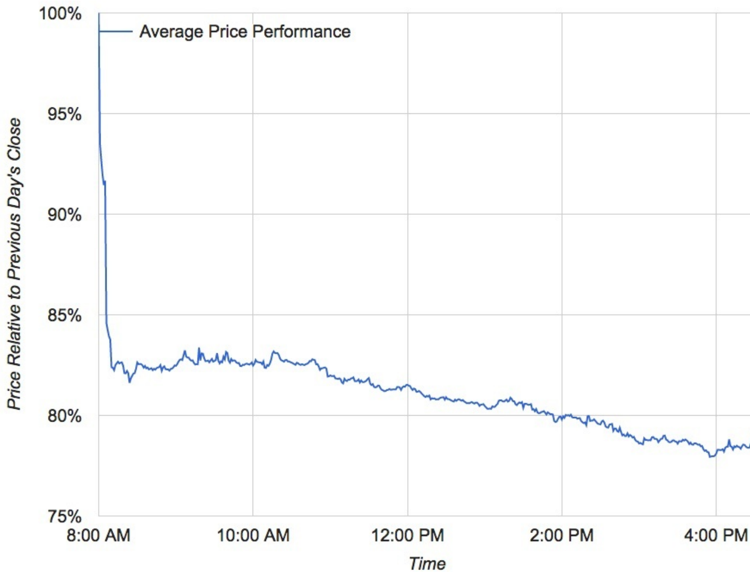
- **Shareholders** see the value of their holding plummet. Knowing the company well, they often think the market has overreacted and refuse to sell.
- **Bargain hunters**, who may have watched the company for some time, sense an opportunity to acquire cheap stock.

Both groups of investors may, on average, be making their very expensive mistakes based on biased perspectives.

Profit warnings are normally announced in the morning before the market opens though very occasionally the news will be released after the market closes. Sometimes Financial PR departments advise management teams to 'bury' bad news at inconvenient hours when they think shareholders aren't looking. But the market is an efficient machine and is rarely fooled.

The price decline when the market next opens is almost always brutal. In spite of the near 6% decline ahead of the event, the typical stock collapses. The average price fall after the first full day's trading is an astonishing **19.2%**. If a stock you own falls less than this, you could perhaps be considered lucky.

Our intra-day price database does not go back as far historically as our daily price database, but we have still managed to collect the intraday action of a set of 60 small cap shares that issued profit warnings during the period. We've averaged their price action on a minute by minute basis, from the first till the last tick of the trading day. This set averages a 21% fall on the day, and here's how it looks:



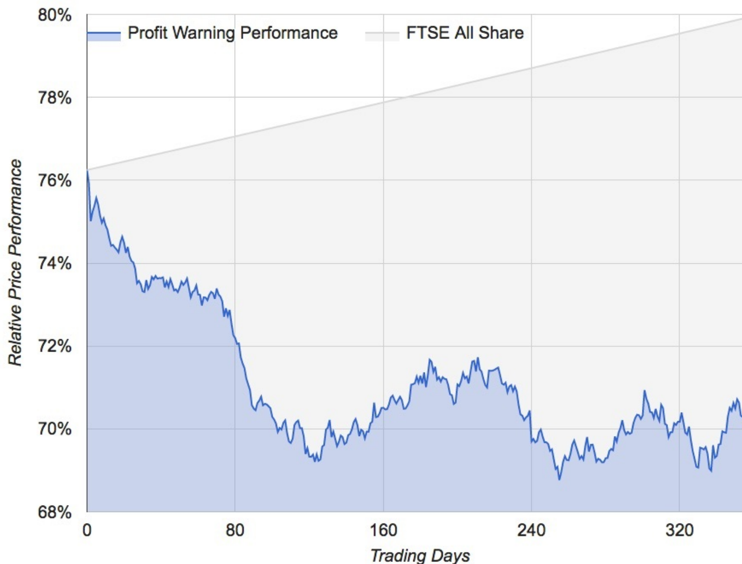
Average Intraday Performance of Profit Warnings

This chart should completely bust the enduring myth that profit warnings over-react. Both during the day and after the day, prices tend to fall, then stay flat or keep declining. Having reviewed all 60 of these shares individually, there's certainly a broad spread of different patterns. Some shares do indeed fall hard at the open and rise slowly to the close, but in general the majority trade not too dissimilarly from this archetypal pattern.

If you experience a profit warning and are considering selling on the day, it is often best to do it as early as possible.

18 months later - the Disappointments of Hope

The next chart magnifies the average price performance from the day after the profit warning until almost 18 months afterwards. Put simply, the price continues to decline by almost another 10% before stabilising. It initially bottoms 31% below and 118 trading days after it started the journey. Over the following 120 days the typical stock attempts a hopeful rally before further disappointments set in.



Average performance in the next 18 months

There is a clear six-month pattern to the entire profit warning move:

- Six months before the warning, the stock underperforms.
- The profit warning hits.
- Six months later, the stock bottoms.
- In the next six months the stock rallies and bottoms again.

- Six months later the stock starts showing signs of stability.

The cyclicality of these oscillations does coincide with the typical six monthly (interim) reporting period of UK companies. This may be a spurious correlation but it is worthy of note.

In any case, the key point is that the average profit warning doesn't recover in price. If anything, the best thing to do is to sell on a profit warning. Here's a great quote from the excellent book **The Naked Trader**, by Robbie Burns, which backs up this point :

The Naked Trader

> It's crazy to buy into a company that
> has just produced a profit warning. And it's crazy to hold onto one of your shares that has just issued one. It's more likely that it will issue another one, and just because its share price has gone down doesn't mean it won't be going down some more !

Why do shares continue to decline after a profit warning?

It's been found that the city analysts who research listed companies and predict profits react slowly to new information, especially negative information. The bad news takes time to be fully digested by the investment community. As new research reports are published, and long term forecasts are adjusted, a headwind is created for the share price. A prolonged period of underperformance often ensues.

What impact does the market environment have?

Previous studies into profit warnings have seen shares recover after six months and go on to show market beating returns in

the following year. Some of these studies though were conducted during strong bull market periods. Our study spans 2013 to 2016 which was a largely sideways trading period for stock markets. These results show that the prevailing market regime may play a great part in whether to buy into profit warning shares or not after a delay.

Indeed Small Cap specialist Paul Scott is a great fan of buying into Profit Warnings during bull markets:

> I always look at profit warnings as potential opportunities - especially in a bull market as this can often be your only chance to buy into a good company at a reasonable price. Also, profit warnings tend to be forgiven much more quickly in a bull market - in a few weeks the share price can be recovering again. **Paul Scott**

What are the odds of recovery after a profit warning?

The previous charts ought to help investors be a bit more brutally decisive after a profit warning, but if they don't the following statistics may help.

We've analysed how many stocks make a full recovery to their previous share price after a profit warning. After a year had passed, *only 13.2% of stocks ended with their share price back above the price before the warning*. In other words, there was an 86.8% chance that a profit warning stock would fail to achieve a new high one year later.

Of course, making a full recovery is not the most important statistic. Once a fall has happened, it's in the past. What's important is whether the stock will outperform the market from that day forwards.

The long run return of equities has historically been around 8% annually, but during this period the FTSE All Share barely made more than 3% annually. A 5% return could have been considered to have outperformed.

- *Only 31.3% of stocks managed to **gain** +5% or more a year after the profit warning had taken its toll.*
- *A galling 44.5% of stocks **lost** an additional 10% or more from the day after the profit warning till 1 year later.*

There are extremely low odds of outperforming the market over a 1 year basis by continuing to hold a share that has suffered a profit warning.

Case Study: MySale plc

MySale is an online retailer that specialised in 'flash sales'. It started life in the Asia Pacific region and was pursuing plans to expand into the UK and US. The company floated on the Alternative Investment Market in June 2014 at 226p per share, valuing it at about £340 million. Six month later it issued a profit warning. MySale said in a trading statement that while revenues for the full year would show double-digit growth, profit-before-tax was expected to be "**materially below market expectations**". While sales were ahead of expectations in new territories, they were considerably down in its original Australia and New Zealand markets.

That day shares in MySale fell by 53% to 81.5p. Over the following three months, the price fell further to 58.5p and to 48.0p within a year. For investors that bought MySale shares at the IPO in June 2014, the value of those shares had fallen by 78.7% in 18 months.

MySale Profit Warning

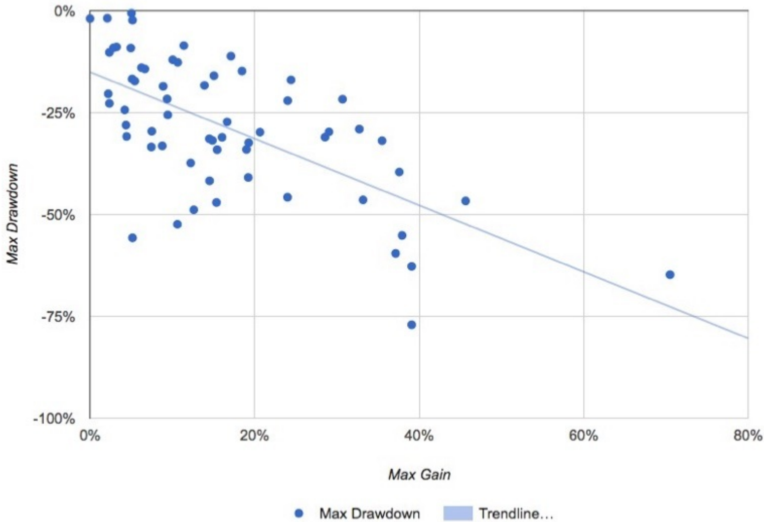
Arguably, one of the aggravating factors that caused such an extreme reaction by the market to the MySale profit warning was the proximity to the company's IPO. MySale warned on profits six months after floating on AIM, and just three months after issuing its

first set of preliminary results. With investors still unfamiliar with the company's business model and financial strengths and weaknesses, the rapid release of a profit warning destroyed confidence.

Do profit warnings bounce ?

One of the common reactions to a profit warning to non-holders of a stock is to 'buy the bounce'. This is based on a belief that the initial share price falls often over-react and that buying at the bottom can provide a handsome profit if the shares are held for a recovery. The previous chapter showed clearly that share prices tend to *fall and keep falling* both during the initial trading day and for many coming months. In fact, the closing price on the day of the profit warning is often the highest price recorded for the next four weeks.

But further analysis shows that there may indeed be a significant opportunity to buy for a bounce in the riskiest scenarios. The following scatter plot shows the size of the maximum drawdown (on the left vertical axis) versus the size of the ensuing bounce (on the horizontal axis). Profit Warnings that suffer the biggest drops do tend to bounce by similarly large amounts intraday.



Profit Warnings - correlation of drawdown size vs bounce

Sadly, actually trading to capture this bounce is likely to be very difficult. While some stocks do rally hard from an initial fall, many have a momentary bounce that is hard to trade around. The difference between bravery and folly may be hard to distinguish.

> Why take the risk? A profit warning means the company is in some kind of trouble or having problems. Why get, or remain, involved on the off chance of a quick bounce back? **Robbie Burns, the Naked Trader**

The other huge consideration for intraday traders is the fact that the bid-ask spread of shares tends to widen enormously. Amongst small caps this can completely wipe out any perceived opportunity. If you see a 10% profit opportunity intraday but the bid-ask spread on a share has widened out to 8%, it's really not a good risk/reward opportunity.

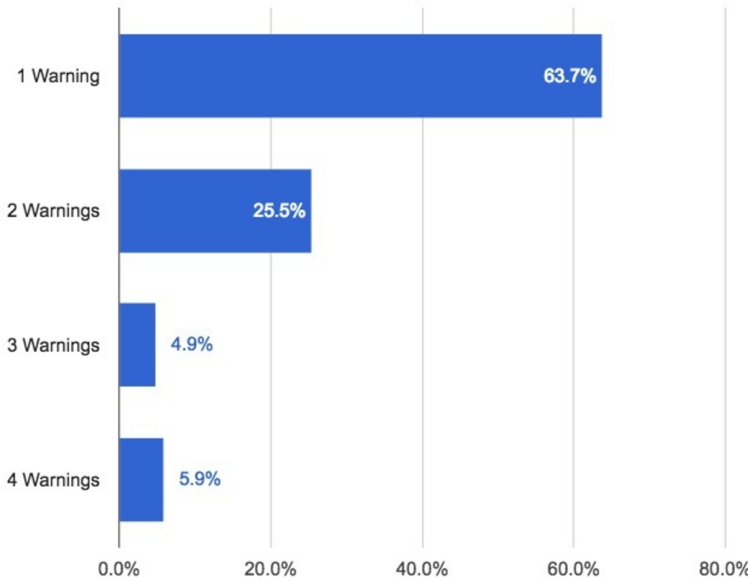
Trading for an intraday bounce in profit warnings, may only be profitable in the shares with the largest, and thus riskiest, intraday falls. It’s best to avoid.

Do Profit Warnings Come in Threes?

One of the great myths about profit warnings is that, like London buses, you don't see one for a while, and then three turn up in quick succession. In fact, the claim that company profit warnings come in threes is so often repeated, that it's assumed to be true - but is it?

To analyse this we reviewed the number of times each company issued a profit warning between 2013 and mid 2016. As we have only studied a limited 3.5 year period we needed to make some amendments to the data set to account for leading and lagging periods. The first year may have contained the *last* in a series of profit warnings for some companies, while the latest year may have contained the *first* of a future series. So we analysed every profit warning in our data set that had both a leading and lagging year's worth of data.

It turned out that during this period, 64% of the companies only warned on profits once, while 36% warned more than once. 11% of the companies warned on profits either three or four times during the period.



Do Profit Warnings come in threes?

In our sample - which covered a limited time period in the small-cap end of the market - there was a clear tendency for companies to issue just one profit warning. However a significant number issued between two and four warnings. This may be enough to propagate the myth that profit warnings come in threes, but not enough to stand up to statistical rigour.

Our numbers are backed up by a study by Ernst & Young (discussed later in this report). This study suggests that the number of companies reporting profit warnings who have already warned in the previous year was between 30% and 45%.

More than 1 in 3 profit warnings is likely to be followed by another, which may explain some of the ensuing underperformance post-announcement.

Drivers of multiple profit warnings

Accounting tricks

So why is it that the majority of companies in the Stockopedia study issued just one warning? One explanation for the trend could be down to ‘big bath’ accounting (or ‘kitchen sinking’). Here, companies manage their earnings so that all the bad news is delivered in one go. This can appear serious in the short term, but it gives the company the chance to move on quickly. If a CEO (particularly a newly-hired CEO) gets a bonus for improving the firm’s financial performance, then there may even be incentives to adopt ‘big bath’ practices to get all the bad news out of the way quickly.

> “The key skill is to avoid companies which are on the slide, and focus on the companies which are fundamentally sound, but have just had a bump in the road for some passing reason. That’s not always easy to differentiate, as management will usually tell you that everything is fine, when it really isn’t. Remember the adage that profit warnings come in threes, so this is a risky area to rummage around in.” **Paul Scott**

Economic influences

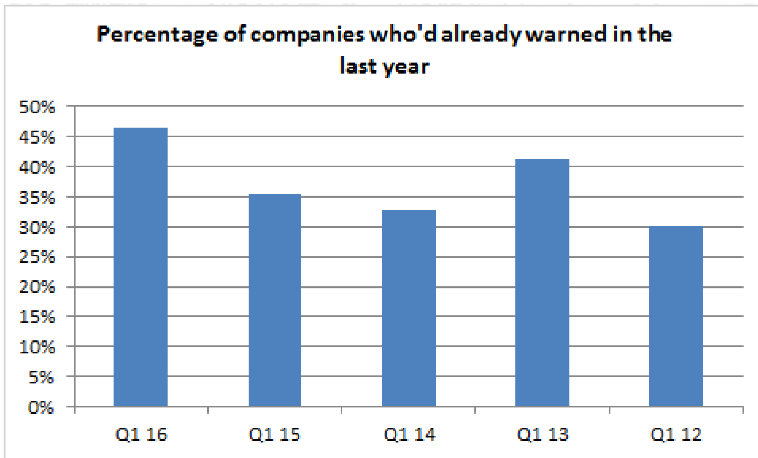
One of the key drivers of multiple profit warnings is the prevailing economic climate. In periods of economic prosperity, companies naturally find it easier to grow and meet their earnings forecasts. But in periods of uncertainty, they are more likely to face trading headwinds and undershoot expectations.

Research by business advisors EY, shows the variation in the number of companies issuing multiple warnings in recent years.

Almost half of companies that warned in the first quarter of 2016 had already warned at least once before in the previous year. A year earlier, in the first quarter of 2015, it was just over a third of companies that did the same.

Looking further, sixteen companies that warned in the first quarter of 2016 had issued three or more warnings in the previous 12 months – compared with nine in the same period in 2015.

The conclusion from these figures is that while profit warnings clearly don't always come in threes, the pattern has become more common in recent years.



Source: *EY analysis of profit warnings*

Faltering financial health

A third factor that drives multiple profit warnings is company financial health. There are some notable shared features in firms that announce warnings, some of which can be seen prior to the bad news, and often continue for a long time afterwards.

Research[6] by Allan Kearns and John Whitley at the Bank of England examined the financial health of just over 500 firms issuing warnings between 1997 and 2001. They found that over three quarters of those firms experienced a fall in profit margins between the set of financial accounts immediately prior the warning and the subsequent year-end set of accounts.

Crucially, fewer than 20% of firms in the study issued a profit warning and then managed to increase growth in their profit margins in the same financial year. In fact, there was evidence that a decline in profitability is not temporary, with around 80% of profit-warning firms failing to grow their profit margins to pre-warning levels within at least two years.

These results show that deteriorating financial health is a trend that can take firms a long time to reverse. Having issued one profit warning, their slow rate of recovery makes it likely that at least one other profit warning will follow.

Compounding the generally negative medium-term outlook for profit growth, the study by Kearns and Whitley found that profit warnings were associated with other signs of adverse financial health. These include increased levels of debt, reduced investment and lower dividend cover, which can put dividend payouts at risk.

Case Study: Dialight - Multiple Warnings

Dialight makes light emitting diodes for use in commercial, industrial and hazardous settings. Sales had been growing strongly and its share price hit a high of 1388p in September 2013. However, a seasonal weighting in earnings and a reliance on large contracts forced it to revise down its forecasts on a number of occasions.

[6] http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/2002/qb020304.pdf

In June 2015 Dialight issued a trading update warning that a slowdown in the rate of orders in its Lighting division was "likely to result in a shortfall in full year revenue". Two months earlier, the company had reported that revenue growth for the first quarter had exceeded expectations but that it had "a number of operational inefficiencies".

On the day of the profit warning in June 2015, shares in Dialight fell by -29.5% to 525p. Over the following three months, the price bounced to 623p, but over 12 months it fell to 515p.

Crucially, the June 2015 profit warning was followed by *another* profit warning in October 2015 - just four months later. It said it faced "an increased level of uncertainty in the remainder of the current financial year".

A common perception among investors is that profit warnings "come in threes". In the case of Dialight, which enjoyed very strong growth between 2009 and 2013, there were multiple profit warnings later on, when the growth became harder to sustain.

For a relatively small business with seasonal earnings and a reliance on large contracts, it's not surprising that it was forced to frequently adjust expectations in the form of profit warnings. Indeed, the rel-

atively quick recovery in price suggests that investors were willing to accept (and even forgive) these profit warnings. Even so, the succession of announcements magnified the impact on the Dialight share price, and it took many months for positive momentum to return.

The Traits of Profit Warning Stocks

Analysis with the StockRanks

At Stockopedia.com we rate every stock in the market against each other across dozens of key risk factors. These come together into a proprietary set of Stock**Ranks** that assess the Quality, Value and Momentum of every stock from zero (worst) to 100 (best).

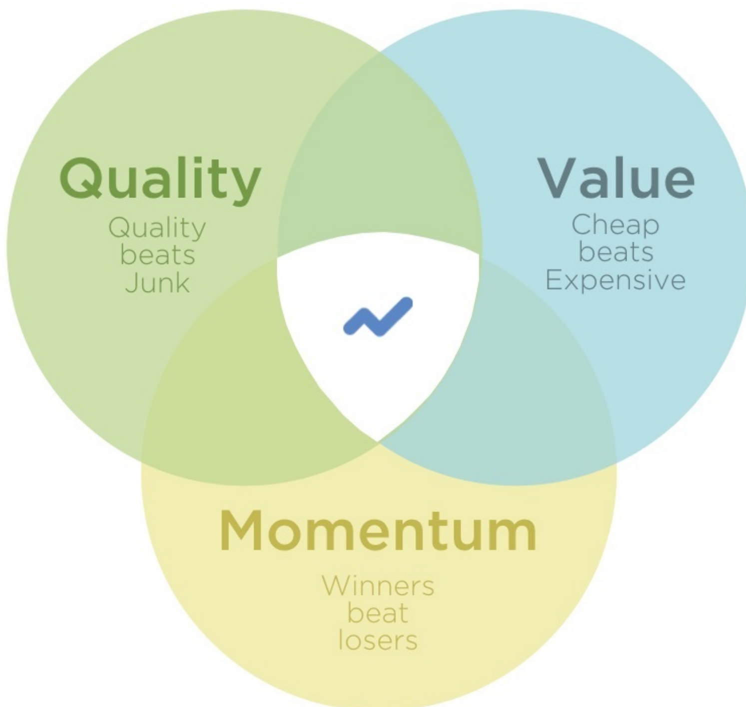
- **Quality** - whether a share is profitable & cash-generative or loss making & burning cash.
- **Value** - whether a share is cheap or expensive.
- **Momentum** - whether a share's price is technically strong or weak.

We also combine all three rankings together into a single equally weighted "StockRank" composite. These rankings provide a lens through which to fundamentally analyse the whole set of stocks. Historically, portfolios of stocks scoring highly for each of these factors have significantly outperformed, while stock scoring poorly have significantly underperformed. You can learn more about the Stock**Ranks** at the Stockopedia Guide[a].

[a] http://help.stockopedia.com/product-guide/stockranks/the-stockranks

Which Stocks are Most Prone to Profit Warnings?

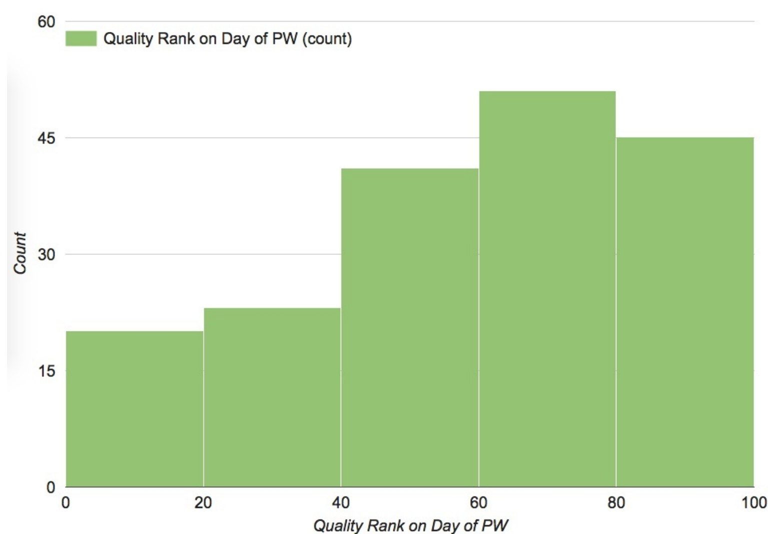
The next several charts show the number of profit warnings for stocks with different exposures to quality, value and momentum.



StockRanks - Quality, Value, Momentum

1. Quality

Profit warnings tend to be more likely for stocks with higher Quality Ranks - i.e. they tend to be more profitable, higher margin firms. This may be because the market already has expectations of profits for these stocks, while speculative issues (such as oil explorers and biotech shares) will not have. So in some ways this is a self-selecting set.

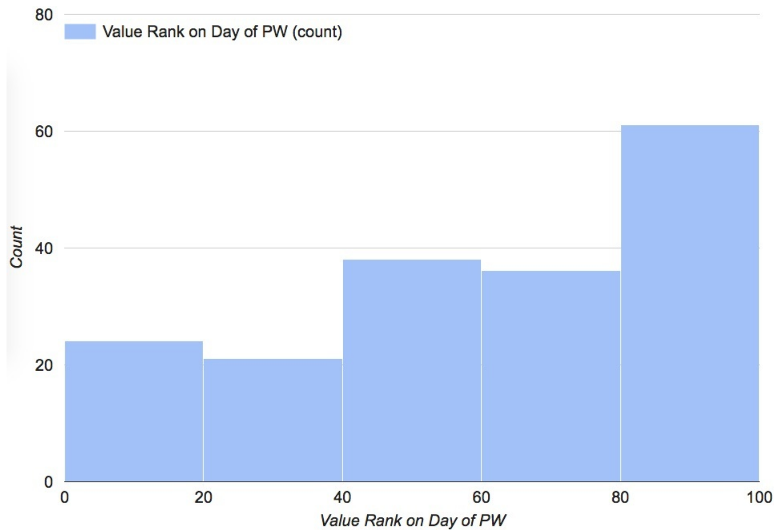


Count vs Quality

If you want to own profitable stocks, which is the only sensible way to make money in the market, expect the odd profit warning!

2. Value

Perhaps unsurprisingly there's also a tendency for the very cheapest shares in the market to issue profit warnings. But it's surprising that the cheapest 20% of the market by Value Rank is three times as likely to issue a profit warning as the most expensive 20%.

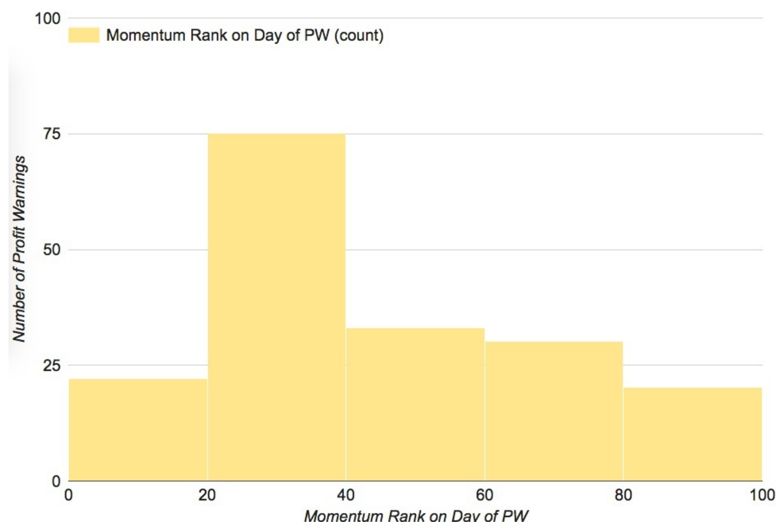


Count vs Value

Cheap stocks come with higher risks. Avoid the very lowest P/E or highest yielding shares to minimise risks of profit warnings.

3. Momentum

Finally, there's a clear trend for lower momentum shares to issue profit warnings. Profit warning shares show a significant 6 month downtrend in share price before the date of the announcement. Poor relative share price strength is possibly the very best leading indicator there is of a profit warning. We found a great proportion of stocks had a rank of 20-40 by our Momentum measure on the date of the warning. The average relative strength was -9.94% while the average broker profit estimate had already been cut by 7.3% in the previous 3 months.



Count vs Momentum

Minimise the number of profit warnings in a portfolio by favouring companies with positive trends (momentum) in both their share prices and their profit forecasts.

Profit warnings and investment styles

By combining these three traits we can figure out the styles of shares that tend to warn on profits. At Stockopedia.com we categorise stocks into eight archetypes according to their investment style. There are **four winning styles** - 'super stocks', contrarian, turnarounds and high flyers - and **four losing styles** - value traps, falling stars, momentum traps and 'sucker stocks'. Each style combines the triad of different StockRanks in a different way. You can learn much more about the StockRank Styles here[7].

Our analysis suggests that there are three styles that are most predisposed to warning on profits:

1. **Contrarian** - cheap, profitable stocks that are suffering from negative sentiment (e.g. Tesco). Contrarian value investing is generally a winning style, but profit warnings are a perpetual hazard.
2. **Value Traps** - cheap shares with poor momentum and poor quality (e.g. French Connection).
3. **Falling Stars** - expensive, high quality stocks running out of steam (e.g. Boohoo).

Value investing is a style that often invests in companies suffering temporary problems, so it's prone to disappointments. Large institutional investors often need a 'contrarian' bias in order to accumulate enough shares at cheap enough prices to generate meaningful returns. But they put themselves at greater risk of suffering from profit warnings. Individual investors don't have to go against the trend as they deal in smaller size. Waiting for momentum to recover can help minimise profit warnings in value stocks.

[7] http://help.stockopedia.com/product-guide/stockranks/advanced/the-stockrank-styles

Case Study: French Connection - Value Trap

French Connection is a UK fashion designer, manufacturer and distributor with retail, wholesale and licensing operations. Shares in the company hit an all time high of 466p in April 2004 but the group has struggled in recent years because of increasing competition and a shift in the focus of fashion retail from the high street to online.

In April 2015, French Connection issued a trading statement warning that *"challenging conditions"* in its retail business meant that retail sales performance in the first half of the year was *"forecast to be materially lower than expected"*.

Five weeks prior to the profit warning, French Connection released its 2015 preliminary results. The company acknowledged that it was experiencing difficult retail trading conditions, which caused its share price to fall by 10.9%.

On the day of the profit warning, shares in French Connection fell by 26.3% to 39p. This sharp decline broadly fits with the average performance seen across the Stockopedia sample.

French Connection's Profit Warning Chart

What makes this event interesting is that French Connection essentially warned investors twice about its trading performance, and it was punished twice, with a -36% decline across the two warnings. There had been an obvious negative drift in price prior to the first warning though less before the second. In the following three to 12 months, the price became very volatile, reaching a low almost exactly 6 months later at 21p, before rising towards the end of the period at around 40p.

Value	78
Quality	52
Momentum	▼ 37
StockRank™	▼ 56

French Connection's StockRank

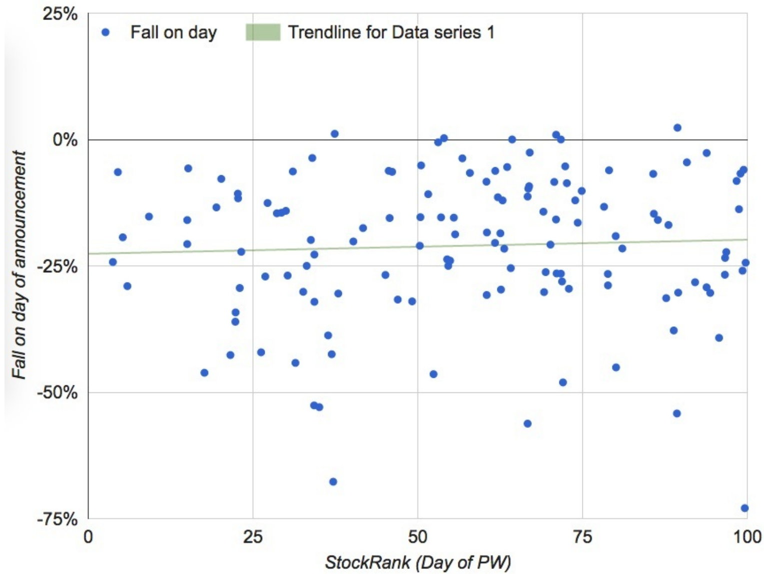
Which Styles are Most Likely to Recover ?

When you look at black ink what do you see ? Black ink ? Well, if you remember paper chromatography lessons from school you may remember that black ink is really made up of many differently coloured dyes. These dyes travel at different speeds vertically up a piece of damp filter paper until they eventually separate into a spectrum of individual colours. There's a way to separate the stocks suffering from profit warnings in just the same way, which we'll illustrate using the StockRanks.

How profit warnings damage share prices

Given the significant outperformance of high UK StockRank shares in recent years, one might expect them to hold up better on the first day of the announcement. Yes one might… but the market is a seriously unkind beast.

The chart below shows each profit warning as a blue dot, with the size of the share price fall on the left vertical axis, with increasing StockRank from left to right. It seems that all classes of stocks, no matter the merits of their fundamental or technical profile, get absolutely hammered on the first day of a profit warning.



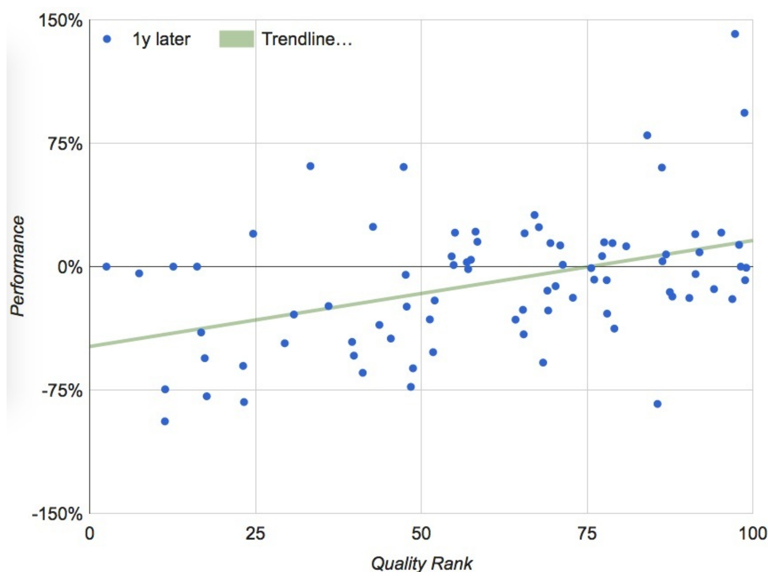
Fall on Day vs. StockRank

The trend line is very gently upwards sloping from left to right which shows a very slightly lower fall for higher ranking shares. But the rule of thumb is that if you invest in small caps, you can't escape the pain of a profit warning. Here's a great quote from Small Cap Analyst Paul Scott that drives this point home:

> "The stellar returns on smaller companies are a great attraction to individual investors, but if you play in this part of the market profit warnings become an occupational hazard. Small caps are usually reliant on a limited number of key customers, suppliers & staff which increase the risks of bumps in the road compared to large caps." **Paul Scott**

Only Quality shares are worth holding for recovery

We've analysed the price rise (or continued fall) for every stock over a 1 year time frame after the initial profit warning slump. While the average stock continues to fall another 10% after the first day slump, some do recover. The only class of stocks with a high probability of recovering are the highest Quality shares. There is no guarantee, and the correlation is not strong, but the green trend line shows that higher quality shares tend to be more likely to recover in price. There is no such correlation for higher Value shares nor Momentum shares.

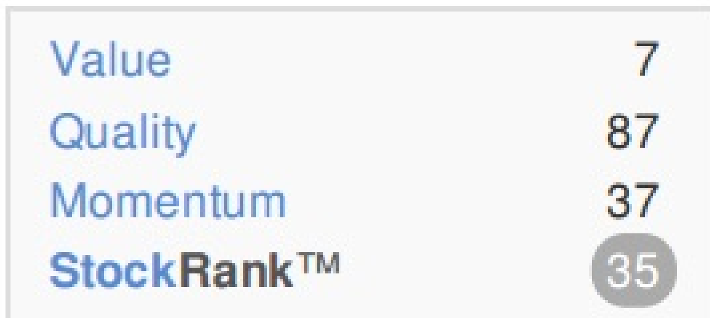


1 year after fall vs Quality Rank

Only consider holding a share after a profit warning if it's **a high Quality company**. A Quality Rank of over 50 is an absolute minimum, but over 75 best.

Case Study: Boohoo.com - quality recovers

When Boohoo.com floated on the stock market in March 2014, investors jumped at the chance to buy shares in the online fashion retailer. At the close on its first day of trading, the company was worth £784 million. Yet, just 10 months later, it issued a profit warning that caused the value of its shares to slump by 42.5%. Despite its huge appeal as a highly cash generative growth stock, Boohoo's valuation nose-dived to £247 million.



Boohoo StockRanks

Boohoo was a classic example of how companies can disappoint investors soon after IPO if they fail to meet near-term growth expectations. For others, though, the plunging price was seen as an opportunity to buy shares in a business with strong underlying quality. Indeed, the day before the profit warning, Boohoo[8] was displaying a Quality Rank of 87 - a key signal that it could recover.

It took 12 months for shares in Boohoo to regain the losses sustained

[8]http://reports.stockopedia.co.uk/154619047/eu/Boohoo_Com_LSE_154619047_20150106.pdf

on the day of the profit warning. But they went on to soar, taking the price well beyond 100p nine months later.

Boohoo - from profit warning to profits

Paul Scott, Stockopedia's small-cap expert, explains:

> There was nothing at all wrong with the figures at Boohoo in my opinion, and I checked them quite thoroughly. It was a rare beast - a high margin online retailer, throwing off organic growth from international expansion, with a growing cash pile, yet where market sentiment was (in the short term) negative due to a failure to meet very aggressive broker targets. I saw this as an opportunity, but only if growth continued at a reasonable pace, which is what happened.

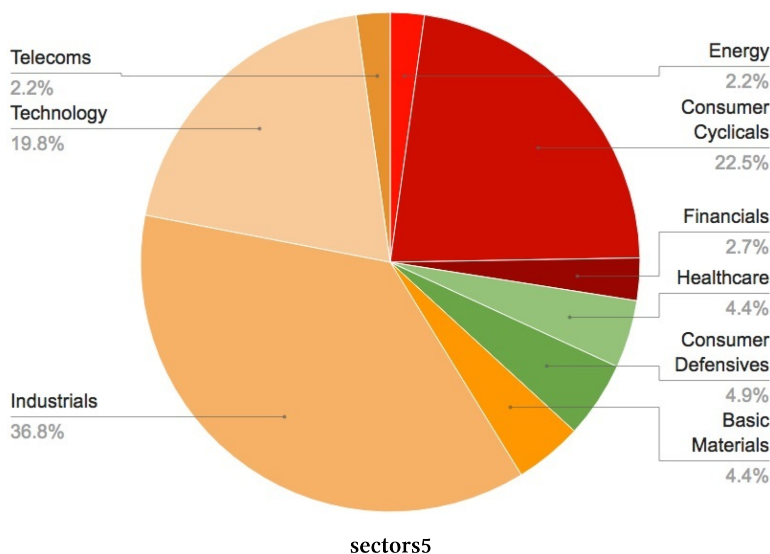
Which Sectors are Least Prone to Profit Warnings?

At Stockopedia.com we split all stocks in the market into three super-sectors - cyclicals, sensitives, and defensives - and ten sectors.

- **Cyclicals**: Energy, Consumer Cyclicals and Financials.
- **Sensitives**: Telecoms, Technology, Industrials and Basic Materials.
- **Defensives**: Utilities, Consumer Defensives and Healthcare

In the study period, we saw very few profit warnings in “defensive” sectors, while economically sensitive sectors suffered a great many disappointments. The Industrial and Consumer Cyclical sectors saw the largest number of profit warnings, closely followed by Technology stocks. The study period showed surprisingly few profit warnings in Financials, possibly due to the easy money policies of central banks at the time. Different market regimes could of course lead to a different sector spread.

The following pie chart shows the sector breakdown of profit warnings, with colour coding into reds (cyclicals), greens (defensives) and oranges (economically sensitives).



sectors5

It is worth considering why we've recorded so few profit warnings in the traditionally speculative energy, basic materials and biotechnology sectors. These sectors tend to be filled with blue-sky stocks that are pre-revenue and therefore don't have earnings. As a result they rarely update the market to say that "earnings will be below market expectations". We believe if we broadened the collection methodology to include alternative forms of disappointment (such as drilling failures, or failed US FDA rejections) there would be far more shares listed in this study in these sectors.

One of the best publications about profit warnings each quarter is the EY (formerly Ernst & Young) "Analysis of UK Profit Warnings[9]". Reviewing this study regularly illustrates that the sectors issuing the most profit warnings change regularly. It comes highly recommended.

[9]http://www.ey.com/uk/en/issues/capital-and-transactions/restructuring/

Ensure exposure to Defensive sectors like Healthcare and Consumer Defensives in order to reduce the number of profit warnings in a portfolio.

Other Studies

The Psychological Reaction to Profit Warnings

At first sight, the market's savage reaction to profit warnings implies that share prices are adjusted quickly and efficiently. But as we've seen, there is evidence that this adjustment is nowhere near as efficient as you might think. The slow reaction of investors means that prices don't fall as far as they really should on the day of a profit warning. That causes them to drift for many months afterwards as the market slowly faces up to the full meaning of the warning.

There are two main emotional drivers behind this:

- the first is a reluctance to crystallise losses on losing positions.
- the second is overconfidence.

Clinging on to losing positions

"Run your winners and sell your losers" is age-old advice in the stock market. Yet behavioural psychologists know full well that human emotions provoke completely the opposite response. Research shows that **the pain of a loss is twice as powerful as the satisfaction of a gain**. For that reason, it's instinctive for investors to hang on to losing positions in the hope they'll recover. This is known as the *disposition effect*, and it's an investing trap door that's possibly the main reason why individual (and institutional) investors underperform.

James Montier, a respected City analyst and behavioural scientist, has noted that profit warnings have a heightened impact on investors, which causes them to get their timing wrong. In

Maximum Pessimism, Profit Warnings and the Heat of the Moment, he explains:

> "Evidence clearly shows that stocks which warn continue to do poorly for around a year. Hence you should sell at the profit warning. Of course, we don't; we procrastinate and often end up doing nothing for a long time."

Montier adds that around 12 months after a profit warning, the prices of companies begin to recover, but it's at this point that people are finally getting around to cutting their losses - far too late.

Research into how the market responds to profit warnings supports the idea that there is an under-reaction. A study by George Bulkley and Renata Herrerias examined a sample of US warnings between 1998 and 2000. They divided them into two groups: those that simply warned that earnings would miss expectations, and a second group in which new earnings guidance was provided. It was the first group that saw the biggest price declines, with an average negative return of -9.6% in the three months following the warning. Their conclusion was that this showed *"evidence of a substantial initial under-reaction to these warnings."*

Avoiding overconfidence in an information vacuum

Like Montier, the researchers Bulkley and Herrerias agreed that the disposition effect may play a role in explaining the under-reaction to profit warnings. But there was more to it. They saw a notable difference in medium term returns between the stocks that warned and those that issued new guidance. It was a subtle but very important difference:

- It implied that **investors are more likely to hang on to stocks that offered no future earnings guidance as part of their profit warnings**. In these circumstances, investors were forced to take confidence - and perhaps be overconfident - in their own abilities to predict the future of the stock.
- By comparison, profit warning stocks issuing new earnings guidance at the same time had essentially taken the guesswork away from investors. As a result, **their prices were much less likely to keep falling over subsequent months**.

This issue of confidence is based on psychological evidence that overconfidence increases sharply when people are faced with inconclusive information rather than indisputable facts.

There is clear evidence that investor behaviour has a major influence on the share prices of companies that issue profit warnings. Loss aversion and the reluctance to crystallise losses triggers a negative momentum effect that can last for many months. For some, it's a phenomenon that mirrors the factors that cause positive momentum - namely that investors develop a mindset that drives prices lower and lower, until they become too low. After a year or more, that behaviour unwinds and prices begin to recover.

** If a stock you own suffers a profit warning but the company does not issue new earnings guidance, be prepared for further future losses !**

Key Insights from Academic Research

Stockopedia's investigation into profit warnings set out to discover the best course of action for investors faced with an earnings 'miss'. Among the key findings are that profit warnings are generally punished severely by the market - and can take many months to stabilise. But does that stack up with the conclusions of existing academic studies of profit warnings? The answer is yes…

The immediate impact on prices

Dramatic price reversals caused by profit warnings are widely reported in academic research. One study by finance professors Dave Jackson and Jeff Madura Profit Warnings and Timing[10] examined 245 profit warnings in the US between 1998 and 2000. They found that that the average price fall on the day of the announcement was -14.7%.

A similar study[11] by Andrew Clare at the Bank of England, examined profit warnings from FTSE 350 firms between 1994 and 2000. It showed that firms issuing bad news about future earnings forecasts suffered an average price fall on the day of -7.1%.

The findings of both studies support what many investors suspect about profit warnings - namely, that they generally provoke a substantial negative reaction from the market.

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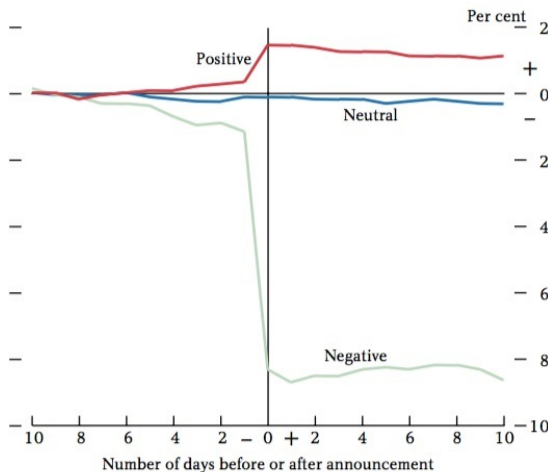
[10] http://onlinelibrary.wiley.com/doi/10.1111/1540-6288.00057/pdf

[11] http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/2001/qb010106.pdf

Price impact surrounding a profit warning

While research into profit warnings shows that negative price action on the day of a disappointment tends to be extreme, the impact over a wider timeframe is even more severe. An important feature of the research into warnings has been to look at how prices react in the days both immediately prior to, and after, the warning.

Jackson and Madura found that the prices of these firms tended to start falling as far as five days ahead of the announcement, and continued falling for five days afterwards. In total, this took the average price reversal on a profit warning to an astounding -21.7% over 11 days. In the UK study, Clare found that the average one-day fall was -7.1%, but over nine subsequent days, the decline stretched to -8.0%.



Cumulative Abnormal Returns after a Profit Warning

There are two notable observations that can be made from these price trends. The first is that information about the imminent warning appears to be anticipated in the days ahead of the an-

nouncement, which causes prices to start falling. This could be because the news has leaked or because the market is beginning to expect bad news.

Jackson and Madura found that, on average, prices fell by -2.4% over the four-day window prior to the announcement.

The second observation is that the tendency for prices to keep falling in the days after profit warnings suggests that the market initially under-reacts to them. In part, this can be explained by behavioural drivers such as the 'disposition effect'. This is the tendency for humans to feel the pain of a loss much more than the enjoyment of a gain, making them more inclined to sell winning positions and hold losing positions because of the unease of crystallising a loss. Studies of price momentum have blamed this behaviour for causing prices to drift on positive and negative news announcements. As a result, the market takes longer than normal to correctly 'price' the full impact of extreme good or bad news.

A final point on future price trends is that the study by Jackson and Madura found that once prices had settled in the aftermath of a profit warnings, they stayed put. They found that there was "no evidence of a reversal after this period", implying that there was no sign that the market response was excessive.

Longer term price impact of profit warnings

On average, the immediate impact of profit warnings on share prices is very negative. But a key question for investors faced with a decision to sell, hold or buy stocks, is how long it will take for prices to begin recovering.

A study[12] by UK finance professors George Bulkley, Richard Harris and Renata Herrerias looked at 455 profit warnings issued between

[12]http://fmwww.bc.edu/repec/res2002/Bulkley.pdf

1997 and 1999 and tracked the stocks until 2001. Similar to other research, the average stock in their sample fell in price by 16.6% on the day of a profit warning, and another 3.9% over the subsequent six months.

Crucially, this study looked further ahead, which meant it could track the prices of profit warning stocks as new information (including earnings announcements) were released to the market. It found that between 12 and 24 months after a profit warning, the average cumulated excess daily returns of these stocks was a positive 23% relative to the market. In other words, the stocks showed strong signs of recovery between one and two years after the warning.

The researchers credited this price reversal to investor behaviour. They pointed to a previous study[13] by Nicholas Barberis, Andrei Shleifer, and Robert Vishny, which found that one-time strong news events (like profit warnings) generate an overreaction. In turn, it argues that investors are slow to change their opinions, even when faced with new information, and this creates the kine of momentum the Bulkley team observed as profit warnings stocks recovered between 12 and 24 months.

The role of analysts in profit warnings

By definition, profit warnings force investors to adjust their expectations about a company's future financial performance. To a large degree, those prior expectations are set by companies themselves and the analysts whose role it is to forecast their earnings.

In their favour, and contrary to popular opinion, there is evidence that analysts do have some skill at detecting profit warnings. One study[14] by Jonas Spohr, examined analyst recommendations ahead of 269 profit warnings between 2005-2011 on the Nasdaq OMX

[13]http://faculty.som.yale.edu/nicholasbarberis/bsv_jnl.pdf

[14]http://njb.fi/wp-content/uploads/2015/06/Spohr.pdf

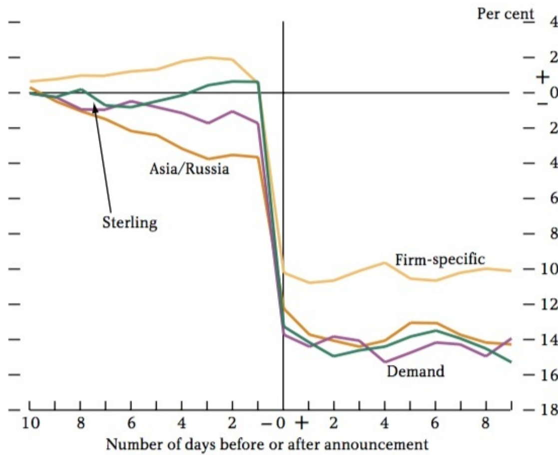
Nordic market. It found that analyst recommendations do start to drift in the direction of the warning about 29 weeks before the announcement.

However, other studies have found evidence that analysts have a tendency to under-react to bad news. One 1999 study by John Easterwood and Stacey Nutt assessed the response of analyst earnings forecasts to new earnings information and found that analysts under-reacted to negative information and, by implication, are systematically over-optimistic.

Different reasons for profit warnings

While no two profit warnings are exactly the same, research into their impact does show some interesting differences when the warnings are categorised. For instance, in Clare's study, warnings between 1998 and 2004 were divided into four, based on the reason they were issued. The categories were:

- [ ] the level of sterling
- [ ] levels of aggregate demand (the general economy)
- [ ] the impact of the Asian/Russian crisis
- [ ] firm-specific factors



Cumulative abnormal returns following specific types of UK trading statements

Interestingly, profit warnings caused by firm-specific reasons suffered the mildest falls in price on average, albeit at around -10%. Meanwhile, warnings driven by macro factors all saw sharper falls, both on the day of the announcement, and in subsequent days.

Clare found that statements relating to domestic demand caused the largest average on-the-day price fall of 13.7%. But over the full 10 days, it was actually sterling-related warnings that saw the biggest average falls, at -15.3%. On this evidence, at least, it appears that the market reacts more negatively to warnings that are caused by macroeconomic factors that are less easy for companies to control.

Conclusions

> The bottom line is that we find it very hard to predict how we will behave when placed under pressure. The best way of avoiding empathy gaps is to do the work with a cool, rational head well ahead of the time when you might experience the impact of emotion and then precommit to that course of action. Hence, when the emotion strikes, the action is already set in motion and you can not interfere. **James Montier, Value Investing**

The severe price falls on profit warnings can deal a huge emotional blow to those unprepared for them. Countless studies show that portfolios managed emotionally can damage investment returns. Our hope is that some of the statistical truths offered in this short guide, and set out in the 'keys', can help investors prepare a checklist for action well ahead of time. Here's a summary of the key takeaways:

- There is no escaping profit warnings. If you own shares, expect profit warnings and prepare a plan for dealing with them.
- Own defensive shares to minimise the number of profit warnings experienced in a portfolio.
- Avoid the cheapest shares by P/E or Yield to minimise profit warning exposure.

- Avoid underperforming shares and shares with poor earnings forecast trends to minimise profit warning exposure.
- When a profit warning strikes - consider selling (or selling short) immediately.
- Only consider buying, or continuing to hold after a profit warning if the shares are of the highest quality - preferably a QualityRank greater than 75.
- Traders should only consider placing an intraday trade during a profit warning if the shares have fallen by more than 30%. But beware the risk!
- Investors should only consider buying after a profit warning when at least six months have passed, and preferably only during a bull market.

Appendix

The List of Profit Warnings

For full transparency here follows a list of all the profit warnings in our research database. We welcome any help in identifying errors in this set of profit warnings. We also welcome the addition of new data points into our set. If you know of any profit warnings that we've missed please let us know. While we cannot guarantee it, we hope to extend this research in future with additional editions and clearer insights. Your help in curating and adding to this list would be extremely welcome.

Name	Ticker	Date of Warning	Price Change(%) On Date
Flowtech Fluidpower	FLO	2016-08-02	-4.52%
Lakehouse	LAKE	2016-08-02	2.33%
Judges Scientific	JDG	2016-07-20	-8.40%
Entu	ENTU	2016-07-19	-26.61%
Christie	CTG	2016-07-18	-6.40%
STM	STM	2016-07-13	0%
Avanti Communications	AVN	2016-07-07	-53.33%
Portmeirion	PMP	2016-07-07	-22.27%
Vislink	VLK	2016-07-06	-54.96%
Brammer	BRAM	2016-06-29	-56.22%
Interquest	ITQ	2016-06-27	-45.09%
Foxtons	FOXT	2016-06-27	-22.59%
Stadium	SDM	2016-06-23	-25.45%
Servelec	SERV	2016-06-15	-30.29%
Getech	GTC	2016-06-10	0.93%
Hostelworld	HSW	2016-05-26	-28.86%
Judges Scientific	JDG	2016-05-25	-16.09%
Marks and Spencer	MKS	2016-05-25	-10.19%
Lakehouse	LAKE	2016-05-17	-28.80%
Driver	DRV	2016-05-10	-31.06%

Name	Ticker	Date of Warning	Price Change(%) On Date
Interserve	IRV	2016-05-06	-16.46%
Robinson	RBN	2016-05-05	-11.43%
Restaurant	RTN	2016-04-29	-26.50%
Pressure Technologies	PRES	2016-04-27	-27.54%
ST Ives	SIV	2016-04-25	-48.06%
Lombard Risk Management	LRM	2016-04-19	-5.32%
Sprue Aegis	SPRP	2016-04-18	-54.21%
21st Century Technology	C21	2016-04-15	-25.00%
Sepura	SEPU	2016-04-04	-32.03%
Hardide	HDD	2016-03-22	-5.71%
Tandem	TND	2016-03-09	-26.76%
Fastjet	FJET	2016-03-07	-36.06%
Volex	VLX	2016-02-26	-16.11%
Alternative Networks	AN.	2016-02-25	-34.74%
Grafenia	GRA	2016-02-24	-8.64%
600	SIXH	2016-02-17	-30.48%
NATURE	NGR	2016-02-15	-6.33%
Hornby	HRN	2016-02-10	-60.80%
Renold	RNO	2016-02-10	-23.98%
WANdisco	WAND	2016-02-10	-19.35%
Cambian	CMBN	2016-02-09	-52.61%
Lakehouse	LAKE	2016-02-01	-58.33%
Creston	CRE	2016-01-27	-15.92%
Plexus Holdings	POS	2016-01-25	-44.20%
Halosource Inc	HAL	2016-01-25	-14.29%
Collagen Solutions	COS	2016-01-20	-15.94%
Quantum Pharma	QP.	2016-01-19	-11.64%
Secured Property Developments	SPD	2016-01-08	0%
Games Workshop	GAW	2016-01-08	-8.91%
Indigovision	IND	2015-12-29	-8.20%
Game Digital	GMD	2015-12-23	-37.79%

Name	Ticker	Date of Warning	Price Change(%) On Date
Pittards	PTD	2015-12-23	-11.29%
Panmure Gordon & Co	PMR	2015-12-23	-19.88%
Bonmarche Holdings	BON	2015-12-16	-29.24%
Tribal	TRB	2015-12-14	-49.43%
Audioboom	BOOM	2015-12-14	-24.24%
Pennant International	PEN	2015-12-11	-15.46%
Mycelx Technologies	MYX	2015-12-11	-46.15%
Vislink	VLK	2015-12-08	-2.59%
Escher Group	ESCH	2015-12-04	-35.23%
Brady	BRY	2015-12-01	-69.70%
ISG	ISG	2015-12-01	-32.12%
Halosource Inc	HAL	2015-11-20	-22.00%
Cdialogues	CDOG	2015-11-17	-55.07%
Majestic Wine	MJW	2015-11-16	4.03%
DX (Group)	DX.	2015-11-13	-72.94%
Ubisense	UBI	2015-11-12	-27.11%
Communisis	CMS	2015-11-12	-14.70%
Brammer	BRAM	2015-11-11	-8.78%
Goals Soccer Centres	GOAL	2015-11-09	-12.05%
Red24	REDT	2015-11-09	-23.42%
Snoozebox Holdings	ZZZ	2015-11-05	-7.79%
Getech	GTC	2015-11-03	-20.69%
Solid State	SOLI	2015-10-29	-26.55%
Amino Technologies	AMO	2015-10-27	-30.35%
Dialight	DIA	2015-10-27	-15.41%
Globo	GBO	2015-10-26	n/a
Alumasc	ALU	2015-10-22	-13.79%
Foxtons	FOXT	2015-10-22	-8.35%
Home Retail	HOME	2015-10-21	-15.83%
Tribal	TRB	2015-10-19	-39.69%
Adgorithms	ADGO	2015-10-09	-61.11%

Name	Ticker	Date of Warning	Price Change(%) On Date
Grafenia	GRA	2015-10-07	-24.69%
Stanley Gibbons	SGI	2015-10-06	-28.57%
Cloudbuy	CBUY	2015-10-05	-28.00%
Speedy Hire	SDY	2015-09-28	-15.54%
RM2	RM2	2015-09-24	-20.69%
International SA Publishing Technology	PTO	2015-09-23	-13.27%
Cdialogues	CDOG	2015-09-18	-18.40%
HSS Hire	HSS	2015-08-26	-38.76%
Blinkx	BLNX	2015-08-24	-16.98%
TechFinancials Inc	TECH	2015-08-21	-25.00%
APC Technology	APC	2015-08-18	-26.92%
Regenersis	RGS	2015-07-14	-19.20%
Progility	PGY	2015-06-29	-20.45%
Tangent Communications	TNG	2015-06-23	-4.35%
Dialight	DIA	2015-06-10	-29.53%
Pressure Technologies	PRES	2015-06-04	-27.78%
SCISYS	SSY	2015-06-04	-29.70%
Tribal	TRB	2015-05-15	-3.66%
Chime Communications	CHW	2015-05-14	-4.04%
SCS	SCS	2015-05-07	-31.39%
Begbies Traynor	BEG	2015-05-01	-12.04%
Ubisense	UBI	2015-04-30	-25.87%
Benchmark Holdings	BMK	2015-04-29	-30.14%
Thorntons	THT	2015-04-29	0.90%
Indigovision	IND	2015-04-28	-22.16%
French Connection	FCCN	2015-04-24	-26.24%
Shoe Zone	SHOE	2015-04-21	-28.25%
Blur	BLUR	2015-04-10	-29.01%
Starcom	STAR	2015-04-08	-13.43%
Stanley Gibbons	SGI	2015-04-02	-6.20%
Real Good Food	RGD	2015-04-01	-14.29%

Name	Ticker	Date of Warning	Price Change(%) On Date
Lombard Risk Management	LRM	2015-03-11	-17.74%
William Sinclair Holdings	SNCL	2015-03-05	-23.71%
Digital Barriers	DGB	2015-02-26	-18.00%
AO World	AO.	2015-02-25	-31.67%
Pressure Technologies	PRES	2015-02-05	-29.53%
ISG	ISG	2015-02-02	-26.17%
Produce Investments	PIL	2015-01-29	-16.91%
Filtronic	FTC	2015-01-28	-20.75%
Intercede	IGP	2015-01-21	-14.61%
Game Digital	GMD	2015-01-14	-30.46%
Boohoo.Com	BOO	2015-01-07	-42.48%
Escher Group	ESCH	2015-01-07	-17.53%
Thorntons	THT	2014-12-23	-22.20%
Cloudbuy	CBUY	2014-12-23	-6.45%
Haynes Publishing	HYNS	2014-12-22	-6.80%
NATURE	NGR	2014-12-19	-33.08%
Promethean World	PRW	2014-12-19	-5.95%
NWF	NWF	2014-12-17	-2.67%
Tribal	TRB	2014-12-17	-9.20%
MySale	MYSL	2014-12-15	-52.96%
Tesco	TSCO	2014-12-09	-6.62%
Games Workshop	GAW	2014-12-08	-5.99%
Belgravium Technologies	BVM	2014-12-04	-7.32%
WH Ireland	WHI	2014-12-03	-5.29%
Transense Technologies	TRT	2014-11-27	-27.66%
Eclectic Bar	BAR	2014-11-25	-26.26%
Harvey Nash	HVN	2014-11-25	-13.31%
Naibu Global International Co	NBU	2014-11-24	-3.17%
Avingtrans	AVG	2014-11-24	-20.80%
MoPowered	HVN	2014-11-24	-24.14%

Name	Ticker	Date of Warning	Price Change(%) On Date
Indigovision	IND	2014-11-11	-15.80%
Sweett	CSG	2014-11-06	-19.12%
John Menzies	MNZS	2014-11-05	-28.09%
TT electronics	TTG	2014-11-04	-30.77%
SuperGroup	SGP	2014-10-31	-6.21%
Photonstar Led	PSL	2014-10-29	-34.21%
Synectics	SNX	2014-10-27	-31.75%
Surgical Innovations	SUN	2014-10-22	-42.11%
Molins	MLIN	2014-10-10	-18.56%
Gresham Computing	GHT	2014-10-09	-29.38%
Latchways	LTC	2014-10-07	-16.79%
Management Consulting	MMC	2014-10-06	-21.57%
Filtronic	FTC	2014-09-26	-20.39%
Plastics Capital	PLA	2014-09-15	-10.82%
Low & Bonar	LWB	2014-09-05	-18.77%
API	API	2014-09-03	-10.87%
Xaar	XAR	2014-08-28	-21.61%
Castings	CGS	2014-08-19	-6.75%
Lidco	LID	2014-08-18	-14.49%
Digital Barriers	DGB	2014-08-11	-12.57%
Hydrogen	HYDG	2014-07-22	-5.45%
Hogg Robinson	HRG	2014-07-22	-9.72%
PuriCore	PURI	2014-07-11	-14.12%
Dart	DTG	2014-06-26	-24.38%
Synectics	SNX	2014-06-25	-22.77%
Filtronic	FTC	2014-06-23	-27.74%
Transense Technologies	TRT	2014-06-13	-15.25%
Getech	GTC	2014-06-10	-11.34%
Hargreaves Services	HSP	2014-05-30	-6.09%
Sabien Technology	SNT	2014-05-29	-20.18%
William Sinclair Holdings	SNCL	2014-05-20	-45.74%

Name	Ticker	Date of Warning	Price Change(%) On Date
DRS Data and Research Services	DRS	2014-05-19	-25.96%
Bagir	BAGR	2014-05-15	-67.72%
Carclo	CAR	2014-05-01	-26.81%
Interbulk	INB	2014-04-22	-5.13%
Spaceandpeople	SAL	2014-04-17	-39.25%
API	API	2014-04-07	-7.43%
Volex	VLX	2014-04-09	-10.85%
McBride	MCB	2014-04-03	-9.24%
Filtronic	FTC	2014-03-31	-21.03%
Kromek	KMK	2014-03-28	-42.65%
Future	FUTR	2014-03-14	-30.19%
Superglass Holdings	SPGH	2014-02-28	-22.22%
Digital Barriers	DGB	2014-02-27	-18.73%
Getech	GTC	2014-02-17	-29.05%
Hyder Consulting	HYC	2014-02-10	-28.38%
Latchways	LTC	2014-02-10	-13.33%
Hornby	HRN	2014-01-24	-3.73%
Braemar Shipping Services	BMS	2014-01-17	-6.81%
Office2office	OFF	2014-01-13	-10.62%
Mothercare	MTC	2014-01-08	-30.60%
Hydrogen	HYDG	2013-12-17	-10.13%
Perform	PER	2013-12-12	-57.85%
Pinnacle Technology	PINN	2013-12-06	-9.21%
NATURE	NGR	2013-11-25	-22.70%
Next Fifteen Communications	NFC	2013-10-29	-23.12%
OMG	OMG	2013-10-23	-2.13%
Interbulk	INB	2013-10-21	-10.17%
Amiad Water Systems	AFS	2013-10-18	-13.54%
Anite	AIE	2013-10-16	-31.78%
Chamberlin	CMH	2013-10-15	-15.24%
Tricorn	TCN	2013-10-04	-6.33%

Name	Ticker	Date of Warning	Price Change(%) On Date
North Midland Construction	NMD	2013-08-23	-15.56%
DDD	DDD	2013-08-23	-23.15%
21st Century Technology	C21	2013-08-08	-41.67%
Nationwide Accident Repair Services	NARS	2013-08-05	-15.67%
William Sinclair Holdings	SNCL	2013-07-29	-15.67%
Impellam	IPEL	2013-07-25	-7.41%
Future	FUTR	2013-07-18	-12.70%
Chamberlin	CMH	2013-07-18	-12.00%
Mission Marketing	TMMG	2013-07-10	-12.38%
Zattikka	ZATT	2013-07-09	-48.28%
Headlam	HEAD	2013-07-08	-5.83%
Zotefoams	ZTF	2013-07-08	-1.71%
Craneware	CRW	2013-06-26	-12.23%
K3 Business Technology	KBT	2013-06-25	-10.96%
Impellam	IPEL	2013-06-19	-6.73%
SDL	SDL	2013-06-18	-29.88%
OMG	OMG	2013-05-30	-12.50%
Cupid	CUP	2013-05-30	-19.08%
Idox	IDOX	2013-05-29	-20.27%
Centaur Media	CAU	2013-05-15	-27.39%
Zytronic	ZYT	2013-05-10	-38.50%
Hardide	HDD	2013-04-24	-23.21%
Next Fifteen Communications	NFC	2013-04-23	-14.10%
Albemarle & Bond Holdings	ABM	2013-04-20	-35.53%
Interbulk	INB	2013-04-17	-11.59%
Mecom	MEC	2013-04-08	-34.33%
Vianet	VNET	2013-02-22	-16.31%
Severfield	SFR	2013-02-19	-4.46%
Tristel	TSTL	2013-02-14	-15.25%
API	API	2013-02-13	-13.04%

Name	Ticker	Date of Warning	Price Change(%) On Date
Densitron Technologies	DSN	2013-02-12	-16.44%
eg Solutions	EGS	2013-02-04	-18.60%
Elektron Technology	EKT	2013-02-01	-14.49%
Intercede	IGP	2013-02-01	-15.44%
Chamberlin	CMH	2013-01-28	-18.37%
Severfield	SFR	2013-01-23	-34.93%
K3 Business Technology	KBT	2013-01-18	-14.77%

How you can help

This project will be a continued effort to analyse profit warnings in the small cap space in UK stock markets. We may publish future reviews of this guide by adding in future profit warning candidates, and this is where you can help.

We've set up a form online to help us capture details of profit warnings from the Stockopedia community. You can find it at this link on Google Forms[15]. If you spot a profit warning please do help us log it by submitting this form - all that's needed is a ticker symbol and a link to the original announcement. We'll do the rest.

We're a small team at Stockopedia.com and much of the data gathering research in this project was carried out by the interns in our summer programme. With your help we'll be able to publish the update to this guide in future years more promptly.

Thanks again.

[15] https://goo.gl/forms/vyTTLFzuOnW4xsz83

Further Reading

For those who want to dig a bit deeper into the research, here follow a collection of our favourite resources on Profit Warnings and Investor Under-Reaction.

On Profit Warnings

- **The information in UK company profit warnings**[16] - Andrew Clare, Bank of England
- **Maximum Pessimism, Profit Warnings and the Heat of the Moment**[17] - James Montier
- **The balance-sheet information content of UK company profit warnings**[18] - Allan Kearns and John Whitley at the Bank of England
- **Profit Warnings and Timing**[19] - Dave Jackson and Jeff Madura
- **Stock Returns Following Profit Warnings**[20] - George Bulkley and Renata Herrerias
- **Stock Returns Following Profit Warnings: A Test of Models of Behavioural Finance**[21] - George Bulkley, Richard Harris and Renata Herrerias

[16] http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/2001/qb010106.pdf

[17] http://ebooks.narotama.ac.id/files/Value%20Investing;%20Tools%20and%20Techniques%20for%20Intelligent%20Investment/Chapter%2012%20Maximum%20Pessimism,%20Profit%20Warnings%20and%20the%20Heat%20of%20the%20Moment.pdf

[18] http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/2002/qb020304.pdf

[19] http://onlinelibrary.wiley.com/doi/10.1111/1540-6288.00057/pdf

[20] http://daac.itam.mx/sites/default/files/u105/daac_-_bulkleyherrerias.pdf

[21] http://fmwww.bc.edu/repec/res2002/Bulkley.pdf

- **Can Analysts Forecast Profit Warnings?**[22] - Jonas Spohr
- **UK Profit Warnings**[23] - Ernst & Young

On Sentiment

- **Inefficiency in Analysts' Earnings Forecasts: Systematic Misreaction or Systematic Optimism?**[24] - John Easterwood and Stacey Nutt
- **The Disposition Effect and Underreaction to News**[25] - Andrea Frazzini
- **A model of investor sentiment**[26] - Nicholas Barberis, Andrei Shleifer, and Robert Vishny

[22]http://njb.fi/wp-content/uploads/2015/06/Spohr.pdf

[23]http://parthenon.ey.com/uk/en/issues/capital-and-transactions/restructuring/ey-profit-warnings

[24]https://www.jstor.org/stable/222503?seq=1#page_scan_tab_contents

[25]http://www.econ.yale.edu/~af227/pdf/The%20Disposition%20Effect%20and%20Underreaction%20to%20news%20-%20Frazzini.pdf

[26]http://faculty.som.yale.edu/nicholasbarberis/bsv_jnl.pdf