FOLEY & LARDNER LLP

# The Art of the Analyst Conference Call and Earnings Forecasts — To Guide or Not to Guide

2007 NATIONAL DIRECTORS INSTITUTE

# THE ART OF THE ANALYST CONFERENCE CALL AND EARNINGS FORECASTS – TO GUIDE OR NOT GUIDE

While many companies continue to offer guidance to the investment community, in recent years several high-profile companies have stopped doing so. A featured breakout session on “The Art of The Analyst Conference Call and Earnings Forecasts — to Guide or Not Guide” at Foley’s sixth annual National Directors Institute on March 8, 2007 in Chicago, focused on this topic in detail.

Moderated by Foley & Lardner partner, Linda Kelso, the panel featured differing viewpoints and personal experiences on providing guidance. Panelists included Steve Calk, vice president, Ashton Partners; Charles Hansen, executive vice president and general counsel, Saks, Inc.; Julie Howard, president and chief operating officer, Navigant Consulting, Inc.; Robert Lamm, managing director, associate general counsel and corporate secretary, FGIC Corporation; John McGinty, advisor, UBS Securities LLC; and Ivan Sabel, chairman and CEO, Hanger Orthopedic Group, Inc.

**The Art of the Analyst Conference Call**

An important point to remember when scheduling a quarterly call is that timing is essential. A company should be careful not schedule its quarterly call to coincide with that of the biggest player in the industry. Participation by the appropriate players also is a key to success. Company representatives on the conference call should include the investor relations officer as well as another high-ranking executive. When the CEO participates on the call, a strong positive message is sent to the investment community regarding the company’s relationship with its investors.

The quarterly call is a valuable opportunity for a company to frame itself and its results in the way it wants investors to view them. The best conference calls do not simply re-hash or re-present the quarterly press release, but rather provide a clear, candid analysis of the company’s results for the quarter and where management thinks the company is headed.

The presentation portion of the conference call should last no longer than ten minutes, with a question and answer period immediately following. Company participants should answer investor questions succinctly, then quickly move to the next question, allowing the discussion and the tone of the call to remain on course. For purposes of courtesy and brevity, investors should be allowed to ask no more than two consecutive questions.

**Why Give Guidance?**

A topic that has become highly debated recently is whether companies should give earnings forecasts, or “guidance,” during the call. The practice of making public earnings forecasts began in the late 1970’s, but no Securities and Exchange Commission (SEC) regulation requires it. Once guidance is given, however, a host of regulatory and other considerations becomes relevant.

In some cases, making a forward-looking statement can create an ongoing duty on the part of the company to update that statement. Giving forward-looking information to the market forces the company to deal with the collective expectations it creates, and legal liability becomes a possibility. Given these unattractive consequences, why do so many companies continue the practice?

In some cases, giving guidance is the best way to gain and to keep the attention of analysts. Ivan Sabel explained that his company, Hanger Orthopedic — a provider of artificial limbs and orthopedic devices — is in the unique position of being the only public company in its field. He views giving guidance as necessary to maintain the coverage that it enjoys from several “bulge-bracket” investment banks. Lack of analyst coverage may lead to lack of liquidity and in some cases increased volatility in stock price. Mr. Sabel explained that his company utilizes the opportunity to give guidance in its conference calls as a way to communicate its strategy. Given that it is a small cap company in an industry that is not easily understood and with no comparable public companies, his company may not be able to hold the attention of its analysts if it did not give guidance. Additionally, as John McGinty pointed out, with the number of research analysts on Wall Street having declined dramatically in the last ten years, the remaining analysts, many of whom are young, inexperienced and overburdened, often will not cover a company with a complex business that does not offer them any guidance.

Charles Hansen presented a different point of view and explained how Saks, Inc. decided to stop giving guidance following six consecutive quarters of missing its earnings forecasts due to severe volatility in the retail industry. Lack of guidance from management has created greater disparity in the analyses of those research analysts that continue to cover the company, but according to Mr. Hansen, this disparity has not caused undue volatility in the company’s stock price. Rather, for Saks, Inc., the risk of volatility is an acceptable trade-off to the negative consequences of giving and then routinely missing earnings forecasts. Another panelist pointed out that despite not giving guidance, most companies in the retail industry give monthly sales results and thus do offer a flow of information to the investment community. In addition, Mr. Hansen explained that the company does make suggestions of certain indicators that management thinks people ought to be looking at with regard to the business over a three or four year range.

Many small companies are absolutely desperate to get the attention of analysts, according to Robert Lamm of FGIC Corporation. Analyst coverage may be the only way to increase stock liquidity, which is of great significance to small companies. Despite the risks and the negative consequences that can result from choosing to give guidance to investors, small companies will almost always choose liquidity. Similarly, the behavior of a company’s competitors can certainly influence the pressure that management feels to give guidance. While large companies like Coca-Cola or Dell do not have to consider the possibility of losing analysts’ attention, smaller companies must look at whom they are competing against for attention in their industry and how those competitors are behaving vis-à-vis the investment community.

Julie Howard explained that her company, Navigant Consulting Inc., continues to give both quarterly and annual guidance despite having been punished at times by the market for missing forecasts. When factors come into play that impact forecasts, the company can use updates to guidance as an opportunity to educate the investment community about the industry environment. For example, unplanned school holidays which result in worker absences can have a sizeable impact on the quarterly results of a company in a service industry. Navigant, which is in the consulting and dispute resolution business, has at times experienced unexpected earnings results when cases settle suddenly. In these situations, offering an explanation to the market can be an effective way to mitigate short-term stock price volatility.

**Quarterly Guidance v. Annual Guidance**

Another trend is the movement away from giving quarterly guidance and toward giving only annual guidance. This trend is consistent with the concern that quarterly numbers contribute to volatility in stock price and encourage an undue focus on short-term results. While some believe that giving quarterly guidance forces management to direct the business with a view toward quarterly results, others believe that giving quarterly guidance does not impact management's thinking about a long-term strategy.

One view of quarterly guidance, however, is that it serves to show systematic progression toward annual numbers. In an efficient market, or one in which all information is known, some volatility in quarterly numbers should not have a significant impact on a company's stock price because the market has an idea of where a company is going in the longer term.

**Updating Guidance**

When updated information becomes available, it should be shared with the market quickly. For example, in the case of bad quarterly results, management should promptly explain that the company will miss its quarterly guidance and note the reasons why. Addressing the market quickly and allowing it to adjust will decrease the amount of time it takes to recover from a bad quarter, and will help maintain a company's credibility.

**Guidance in the Age of Regulation FD**

Led by audience questions, the panelists focused on the topic of Regulation FD. Panelists espoused differing views as to the effect of FD on the ability and the willingness of companies to interface with analysts and the investing public. One panelist stated that Regulation FD has made it easier for in-house counsel to guide a company's IR department to engage in only appropriate communication with analysts, i.e., it has made the practice of not responding to inappropriate analyst questions acceptable.

Another panelist believes that Regulation FD, and more specifically the SEC's Regulation FD enforcement actions, have had a chilling effect on most interfaces between companies and research analysts. Management must be extremely cautious not to communicate any information to analysts that is different from what was said at the time of the last conference call. Consequently, the relationships between research analysts and management are weaker and less mutually beneficial than in the past, especially where a company has chosen not to give earnings guidance.

**The Future of Earnings Guidance**

The practice of providing earnings guidance will evolve along with the regulatory and investment community landscapes. While the gap between companies and analysts may have been widened by Regulation FD and its enforcement, and many banks are no longer willing to fund research, others will see opportunities to make money from inefficiencies that become apparent in the market. Funds and their money managers will do more of their own research, and the investment community will have additional forecast sources.

**Summary**

Despite the movement away from earnings guidance by some high-profile companies and the growing list of arguments against the decades-old tradition, many companies remain committed to the practice. The issue is and will continue to be subject to much debate. Providing guidance can be an opportunity to educate investors about what drives a company's business, management's objective should be to educate the market. On the other hand, a company within a highly volatile industry, or a company that does not have appropriate systems and staff in place to make forecasts with a high degree of accuracy, should not give guidance. In addition, large companies that are well established in their industries may have no need to give guidance. As with so many other business decisions, the decision to guide or not guide is never a simple one and always is influenced by a particular company's unique business, industry, management team, size, resources, competitive position, and capital needs.

## For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.


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Save the date! The 7th Annual National Directors Institute will be held on March 6, 2008 in Chicago. Learn more at Foley.com/ndi.