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Investors Reward Guidance, Even if News Is Bad

Companies that provided early warnings when they expected to miss an estimate enjoyed better returns than those that failed to announce an earnings miss beforehand, a new study finds.

Kate O'Sullivan, CFO.com | US
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During the first quarter of this year, as the Dow approached 6,500 and appeared to be in an endless freefall, many finance chiefs struggled with the impulse to hole up in their offices and not take calls. But those who fought that impulse were rewarded: a new study from investor-relations firm Sharon Merrill Associates and research firm eventVestor finds that companies that provide earnings guidance and preannounce earnings surprises realize superior stock-price performance compared with firms that don't provide such communications.

The study, which analyzed stock-price returns for the S&P 500 and the Russell 1,000 in the 10 trading days before and 20 trading days after preannouncements and earnings announcements during the first quarter of 2009, found that companies that provided guidance performed better than those that did not, even when their actual earnings missed analysts' estimates. When they exceeded analysts' expectations, they outperformed other companies that also did better than expected but did not provide guidance.

Those that provided early warnings when they expected missed estimates experienced better returns than companies that failed to preannounce an earnings miss. "We were very surprised by that finding," says Maureen Wolff-Reid, president and partner at Sharon Merrill, adding that many executives think their companies will be punished twice for coming out with an early report that they are going to miss analysts' targets: once with a decline on the day of the announcement and again when they formally release the full quarterly results. "Because the first quarter was a pretty negative quarter, it could be that investors thought results were going to be a lot worse," she says. "Getting the information out there right away put a floor in for people." Sharon Merrill's analysis also revealed that companies that promptly followed a quarterly earnings miss with a downward adjustment to their annual guidance performed better than those that let their annual number stand despite a disappointing quarter.

To be sure, many big-name companies — including Unilever, AT&T, and Gillette — have pulled back from giving quarterly earnings guidance recently. But Jeffrey Morgan, president of the National Investor Relations Institute, says the Sharon Merrill report shows how much today's skittish investors value transparency. "The more you allow people to see what is going on in your company, the more you are rewarded, or the less you are harmed," he says.

Wolff-Reid, whose firm works primarily with smaller and mid-cap companies, says her clients "have a concern that they won't have anyone following them if they don't have some type of guidance out there." In addition to the loss of valuable analyst coverage, "they feel that if they pull back on guidance completely, they would really take a hit in the market," she says.

Nevertheless, many companies are struggling to develop reliable forecasts of any kind. Some are issuing wider guidance ranges than in the past, while trying to provide more color around the numbers. Michael Shea, finance chief at Mac-Gray, an operator of laundry facilities for apartment complexes and dorms, says that while his management team "went around and around" on the question of whether to provide guidance this year, it decided to continue providing an annual revenue estimate.

The company also gives a wider guidance range than it did before. "I get some criticism that Mac-Gray gives too much of a range," says Shea. "But then I get some credit for giving one at all."

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