

TRANSPARENCY AGAIN DELIVERS SHAREHOLDER VALUE IN A BULLISH QUARTER FOR STOCKS

Companies that provide earnings guidance and pre-announce downside earnings surprises continue to realize superior returns

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Executive Summary

Continuing a quantitative study of earnings guidance first published in June 2009, IntelliBusiness and Sharon Merrill Associates analyzed the financial results reported by publicly traded companies in the second quarter of 2009¹. This analysis generally confirmed what we observed in the unusually bearish 1Q 2009 period conditions that were captured in the previous study. As we expected, however, the updated findings were different in some respects – most likely reflecting the stronger market environment and more positive investor sentiment in the 2Q 2009 period.

- **Companies that did not provide guidance were again punished more severely for missing the analyst consensus estimate than companies that did provide guidance.** Among S&P 500 companies missing consensus, for example, those providing guidance saw an average 1.1% stock price decline versus the market 20 days after reporting earnings (including the day of the release), compared with a 3.1% decline for those not providing guidance.
- **Pre-announcing quarterly results that fell short of guidance improved stock price return, but upside pre-announcements had no impact.** The prior study found that upside and downside pre-announcements both improved returns. In the 2Q 2009 period, companies that pre-announced a downside miss again outperformed those that did not pre-announce. Companies that pre-announced a downside miss saw a 0.7% stock increase compared with the market in the 20 days after pre-announcing (including the date of the pre-announcement) and also experienced a 2.0% favorable return compared with the market in the 20 days after issuing their actual earnings release. This compares with a 5.4% decline compared with the market after the earnings release was issued by companies that did not pre-announce.

However, the stocks of companies that pre-announced a positive guidance surprise in the 2Q 2009 period performed about the same as those of companies that beat guidance but did not pre-announce.

¹ Using the IntelliBusiness/eventVestor® analytics platform, we measured “abnormal stock price return” for S&P 500® and Russell 1000 companies in the 10 trading days before and 20 trading days after their pre-announcements and earnings announcements during the second quarter of 2009 period, based on their guidance practices and their results versus the consensus of analyst estimates. Guidance data was sourced from company press releases and SEC filings. Abnormal stock price return is the difference between a single stock’s performance and the average market performance over a set period. In our analysis, we used the S&P 500 index as the benchmark for the average market performance. For example, if a stock increases by 7% on the day a company raises its earnings guidance and the S&P 500 index was up by 2% on that day, then the abnormal return was 5%. On the other hand, if the market reference index performs better than the individual stock, then the abnormal return would be negative. (Companies experiencing under -10% or over +10% daily abnormal returns during the event window were excluded to control for outlier events.)

- **Unlike the prior quarter, companies that reported a quarterly earnings miss for the 2Q 2009 period were no better off lowering their full-year guidance.** In the June 2009 study, companies that maintained their full-year guidance when reporting quarterly earnings below the analyst consensus experienced inferior stock price returns relative to the market and to companies that missed the quarter but lowered their full-year guidance. In the second quarter period, however, companies that did not lower their full-year guidance when reporting a quarterly guidance miss experienced returns comparable to those of the overall market. At the same time, companies that lowered their full-year guidance experienced inferior returns (2.6% decline compared with the market in the 20 days following the announcement, including the date of the release). We believe this reflects the positive shift in market sentiment in the 2Q 2009 period. One might also speculate that during the first-quarter period investors were highly skeptical of companies that did not lower full-year guidance after missing quarterly expectations, considering the bearish market.

We concluded our June 2009 report by questioning, given the unusually bearish environment in the 1Q 2009 period, whether our findings had predictive validity. We speculated that in such an extraordinarily fearful trading environment, investors may have placed an exceptionally high premium on earnings guidance, and that an identical study conducted during a more bullish period might not yield identical results. The market has rarely been more bullish than it was during the 2Q 2009 period, yet the eventVestor data again confirmed the benefits of providing investors with greater transparency through guidance.

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About Sharon Merrill Associates Sharon Merrill Associates has been developing results-based investor relations and corporate communications campaigns for nearly 25 years. All of our engagements, from investor outreach and perception audits to corporate communications and media campaigns, are implemented from a strategic plan to achieve clients' goals. SMA's senior team has significant experience in the capital markets, and we are known for our ability to become experts in our clients' businesses. Our creative thought process and unparalleled responsive service provide clients with cutting-edge communications programs, executed by proactive, industry thought leaders.

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