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CEOs Turn Mum About Projecting Earnings

Those Providing Forecasts Fell Last Year to 55% From 72%; Drawback for Smaller Investors?

By Gregory Zuckerman

MORE COMPANIES are trying to kick the habit of providing earnings guidance, which is injecting a dose of confusion into the markets.

For years, companies pointed investors and Wall Street analysts to their expected quarterly profits through regular hints or outright forecasts. The nudges sometimes were public, but other times they were given privately to select analysts and large investors. Companies then tried to beat those estimates, if only by a penny or two a share, hoping to signal that business was on an upswing.

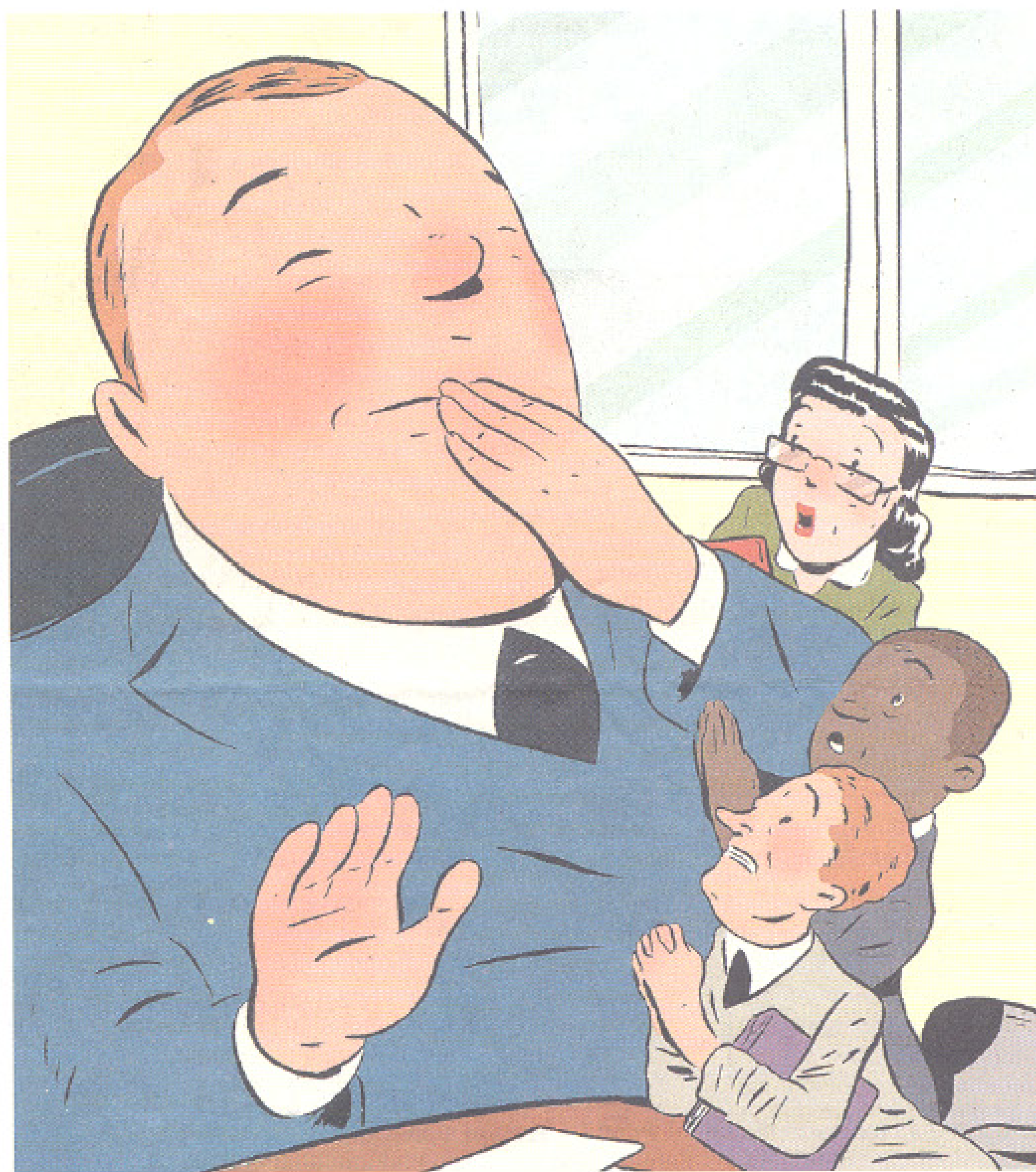
Often, companies felt pressure to meet the predictions they provided. Some allegedly resorted to aggressive accounting to hit their projections. In the continuing trial of Bernard Ebbers, the former chief executive of WorldCom Inc. is accused of urging an executive to make sure that the telecom giant "hit our numbers" as a way of suggesting that WorldCom make improper accounting moves to meet its financial forecasts.

But a shift is developing, and more companies are trying to get away from this kind of regular profit forecasting. Just 55% of companies offered earnings and financial guidance to analysts last year, down from 72% in 2003, according to a new survey of chief financial officers, treasurers and assistant treasurers at 385 major U.S. companies, conducted by consulting firm Greenwich Associates.

Among the largest 300 companies based on revenue, 60% gave earnings guidance to analysts, down from 79% in 2003. Nearly 10% of the companies that continue to give out such guidance say they expect to slow or halt it in the future.

Some say less earnings information could put smaller investors at a disadvantage. "The downside is investors aren't getting information that companies could be giving out, such as a legitimate bit of information about how a company will grow units and pricing, because restrictive disclosure rules make them uncomfortable," says Julius Ridgway Jr., who manages the stocks of individual investors at Medley & Brown, an investment advisory firm in Jackson, Miss. "That has some value."

Companies that have stopped issuing regular earnings-per-share guidance, or are restricting it to just annual forecasts, include **Clear Channel Communications** Inc., **Alcoa** Inc., **AT&T** Corp., **AutoNation** Inc., **Mattel** Inc., **Sun Microsystems** Inc. and **PepsiCo** Inc. Executives at **Google** Inc. expressed a distaste for such guidance when they brought the company public last year, citing the example of Warren Buffett's **Berkshire Hathaway** Inc., which doesn't guide investors.



Louis Thompson, president of the National Investor Relations Institute in Vienna, Va., says investor-relations executives are moving away from predicting quarterly earnings to guiding investors on annual earnings, or to giving other kinds of information, such as revenue predictions. A survey by his group last summer showed

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Companies' Silence Might Put Smaller Investors at a Disadvantage

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39% of companies provided quarterly earnings-per-share estimates, down from 52% in 2003.

The change is an outgrowth of recent regulatory moves that have added more restrictions to how companies can communicate with investors. The U.S. Securities and Exchange Commission's Regulation Fair Disclosure, for example, stipulates that material news can't be shared selectively with investors. The rules were put in place to level the playing field, so that large investors didn't get corporate information that smaller ones missed out on.

Some investors argue that the new rules have made companies so worried about violations that they are cutting back on their communications with investors. Some also may be less open with investors in reaction to the corporate scandals of the past few years, or are simply using the new rules as an excuse to curtail the information they disclose, some investors argue.

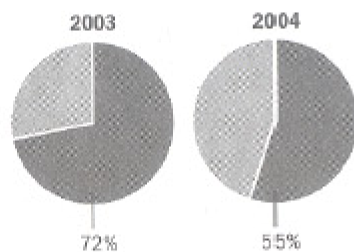
But the change also reflects how more companies are trying to discourage investors from judging them over the short-term, to enable the companies to generate better long-term growth, a trend that could be healthy for the economy.

Edward Lampert, chairman of **Kmart Holding** Corp. and another follower of Mr. Buffett, has a policy against giving earnings guidance, or even conducting quarterly conference calls with investors and analysts, in part to push his own managers to focus on the long haul. Mr. Lampert has pointed out that companies that focus on meeting quarterly profit figures sometimes sell products at a lower price at the end of the quarter or take other costly steps to meet the guidance.

Barry Diller, chairman and chief executive of **IAC/InterActiveCorp**, says that two years ago he decided the media company should no longer provide a range of likely earnings, but rather would provide business trends, because he didn't want his executives making decisions to try to match investors' short-term expectations.

Fewer Forecasts

Percentage of U.S. companies surveyed that provide earnings guidance to analysts



Note: Based on responses from 385 companies
Source: Greenwich Associates

"The more I began to understand the Wall Street game, the more I realized that [giving such guidance] doesn't have anything to do with building long-term value. It's a kind of ritualized Kabuki dance," he says. "Most corporations are concentrating on making their numbers, but none of it has a single thing to do with actually building a business, and a good part of it is inimical to that, because you can't run a business on quarters."

Some executives say businesses change at a faster pace than ever, as more rely on just-in-time supplies, among other things, making it harder to set out reliable predictions.

Mr. Diller says the reaction from investors at first was "lousy." Indeed, some companies that don't give investors enough of a sense for where their business is heading seem to get penalized by the market. Last year, Chris Hussey, an analyst at Goldman Sachs, issued a report about **EchoStar Communications** Corp. saying the satellite-television company "remains one of the quietest companies—in terms of disclosures—further adding to the risk of an investment in its shares."

Recent academic work suggesting that companies often forgo long-term profits to meet their earnings guidance also has had an impact. In a much-talked-about study, Campbell R. Harvey, professor of finance at Durham, N.C.'s Duke University, along with two colleagues interviewed 21 chief financial officers. As many as 78% of them acknowledged that they would sacrifice long-term value by cutting things such as research and development or putting off a promising project if it enabled their companies to meet earnings expectations.

"CEOs must say 'no' to the earnings-guidance game and reverse recent practices in which analysts took the lead in driving industry forecasts, and companies complied," argued Michael Jensen of Harvard Business School and Joseph Fuller of Monitor Group, a consulting firm, in a 2002 paper.

The change also is a result of a push by investment banks to cut the number of companies they follow, reducing the opportunity for companies to signal earnings guidance, even if they wished to do so.

So, investors and analysts are being forced to do more legwork on companies, rather than have earnings trends handed to them. That has made it harder for investors and analysts to guess where earnings are going. Last year, companies in the Dow Jones Industrial Average reported earnings that met the expectations of analysts less than 20% of the time, according to data company Thomson Financial, down from more than 30% in 1998. More than 50% of the time, companies beat earnings expectations by more than a penny a share. Google shares, for instance, soared more than 7% early last month when the Internet-search giant posted fourth-quarter earnings that beat expectations by almost 20%.

Some larger investors, like mutual funds and hedge funds, say they have come to embrace an era of less earnings information. Many of these investors have resources to dig up industry trends and think they can make an educated guess at where profits are going.

Says money manager Bill Miller of mutual-fund giant Legg Mason, "We're not big fans of guidance, we like to do more of our own research and not have companies focus on quarterly earnings."

Medley & Brown's Mr. Ridgway, who works with individual investors, argues that these investors can still do well by focusing on what executives are saying about their long-term goals, so the changes might not hurt individuals. "I find it more valuable hearing what a CEO says about where a company will be five years from now," he says.

It isn't clear how much further the trend will go. Some major companies, such as **General Electric** Co. and **Wal-Mart Stores** Inc. continue to regularly update investors about their likely earnings. Even Coca-Cola Co. made an exception last September to its vow to withhold earnings predictions when the company realized that the second half of the year would be much worse than analysts were expecting. "That was a one-time exception; we thought it was appropriate to update investors," says Ben Deutsche, a spokesman for Coke.