NIRI Virtual Chapter

Program Wrap-Up

Program Title: Strategic Roadmaps – an Alternative to Quarterly Earnings Guidance

Program Date: November 14, 2018

"*If we don't give guidance, how will investors know how to value us*?" "*Why do we give guidance in the first place*?" "*Are we just feeding into a short-term mindset if we give guidance*?" "*Should we give guidance for even longer than a year*?" Questions like these come up at many public companies, from operational teams all the way up to C-level and the board. It's answering them with any level of confidence that becomes difficult; every company is different, with varying levels of visibility into future performance as well as different investor bases.

Traditionally, investors will always prefer more information to less, and the more granularity the better. However, in the last several years we've started to see a groundswell of support for a longer-term approach eschewing quarterly guidance coming from both issuers *and* members of the investment community, who are becoming more aware of the impact of short-termism on how their investments operate.

NIRI Virtual Chapter provided a window into this discussion in its November 14th session *Earnings Guidance OUT, Long-Term Roadmap IN*? – with a lively discussion among both the issuer and buy-side community. Representing issuers were Jeff Glajch, CFO of Graham Corporation, and John Cummings, SVP of Investor Relations at Salesforce.com. Speaking for the investment community were Lori Keith, portfolio manager with Parnassus Investments, and Sarah Williamson, CEO of FCLT Global and a former buy-sider at Wellington Management. Here's what we learned:

Quarterly guidance isn't as common as you'd think, and for most companies doesn't improve valuation or lower volatility in the long run. 28% of the S&P 500 currently provide short term guidance. Shorter-term investors may benefit from uncertainty around earnings release periods – a Harvard Business Review study from 2012 showed companies using more short-term language on conference calls had shareholder bases with more "'transient' than 'dedicated' investors.'"

Investors want information from issuers that matches their investment horizon. An investor that expects to maintain its holdings for a 5-year period will want the board and management of its holdings focused on producing value over that same horizon, as long as it's something that they can effectively forecast. Further, an FCLT study shows that only 7% of *investors* want companies to offer guidance on *any* metric for periods of less than one year; 85% of investors in a 2018 FCLT survey prefer guidance of 3+ years, with 25% preferring 5 or more years, again, likely matching their investment timeframe.

Longer-term approaches at a company have multiple benefits both internally and externally:

-Changes in disclosure can have an impact on operations – which may be a positive. Research has shown that companies moving away from guidance make larger investments in R&D and capex – items that if managed properly will have a return to the company outside the typical quarterly or annual range of guidance.

-**Internal time horizons of longer than a quarter help align all parts of the company**. An IIRC survey of companies that extended out their guidance periods saw 79% of managers reporting business decision-making had improved, and 78% citing better collaboration between the board and management.

-**Longer-term guidance matches management's compensation focus**. For most companies in the say-on-pay era, a well-formed compensation plan incentivizes management

Many of the standard objections to lengthening out the cycle aren't that hard to overcome. Issuers are naturally concerned about the next quarter – and yes, an NYU / University of Florida study did report that *ending quarterly guidance does correlate with lower analyst coverage and higher forecast dispersion in the short term*. The chief concern of participants in an in-session survey by far was "buy-side and sell-side analysts won't be able to properly model the company." However, if you assume finite bandwidth from investors, *converting* some of the time the company spends communicating from the short-term to the long-term actually *matches the value inherent in investors' models* – the majority of value in a DCF model with a typical discount rate is not this quarter, or even this year, but in the cash flows 3+ years out.

If you do make the change, do it right. Above all, investors don't like downside surprises. If you choose to change your guidance policy, *give advance notice of the change*, perhaps even several quarters in advance. Further, if you're removing metrics that you're reporting, *find a better metric to replace* it that might better describe the company's longer-term approach, and keep updating it. One comment from the session: "Issuers are worried about giving investors numbers they have to change," but if those values are long enough term, "investors are just fine with that."