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Quarterly EPS Guidance Targeted, and Quadrophobia Allegedly Investigated

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A **recent WSJ Op-Ed** from Jamie Dimon and Warren Buffet, together with the Business Roundtable, encouraged all public companies to move away from providing quarterly EPS guidance. The Council of Institutional Investors (CII), cited as "the leading voice for strong shareholder rights," is quoted to represent investors in support of the premise.

Reports indicate that only about a third of the S&P 500 continues to provide quarterly guidance, or one in five public companies generally. That data is largely consistent with a 2016 survey by NIRI, which shows that 67% of the companies that responded choose to provide annual guidance and another 20% provide guidance that spans more than one year. In June 2018, NIRI issued **a policy statement** that advocated focusing on guidance that underlies long-term strategy, provides insight on one year or longer periods and includes a consistent set of both financial and non-financial metrics. Guidance should be positioned as a range of reasonable potential outcomes for each timeframe and metrics, instead of a single point or an unreasonably narrow range.

The effort is not new, as **an article in the Harvard Business Review** four years ago advised companies on how they should start to move away from the practice. Like NIRI, it urged companies to communicate a clear strategic plan and provide information on non-financial performance indicators as well. The article also suggested that companies emphasize that their boards had been involved with the decision to discontinue quarterly guidance, a decision made to emphasize long-term value and not due to increased uncertainty or concern over business conditions.

While moving away from trying to meet short-term targets is widely accepted as a positive behavior change, whether it impacts the market for the company's stock, stock volatility or even management focus continues to be debated. A **study two years ago** concluded a "null" effect, albeit with a small sample size, and found that companies that provide 3 to 5 year long-term range forecasts have no difference in investment levels, sensitivity or what it calls "managerial myopia" in desiring to meet or just beat quarterly earnings estimates, and investors do not react differently to quarterly earnings or other short-term guidance news. However, **another academic study** found benefits for companies that stopped quarterly earnings guidance in terms of having a larger proportion of long-term investors and less sensitivity to analysts' short term forecasts.

In other **recent stories about EPS**, this time reported EPS, publications are reporting that the SEC is investigating whether companies are "strategically rounding" EPS so that the digit "4" rarely appears in the tenth place. A 2014 academic paper, which is being updated, called this quadrophobia. The paper found that from 1980 to 2013, "4"s appeared in the tenth place only 8.5% of the time and "2" and "3" were also underrepresented, while digits 5 and above appeared more frequently than by chance, an anomaly only shown in EPS reporting and not in other financial reporting metrics.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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