LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY AUGUST 14, 2024

DR. T ON SECURITIES

Balancing communication and compliance in earnings releases

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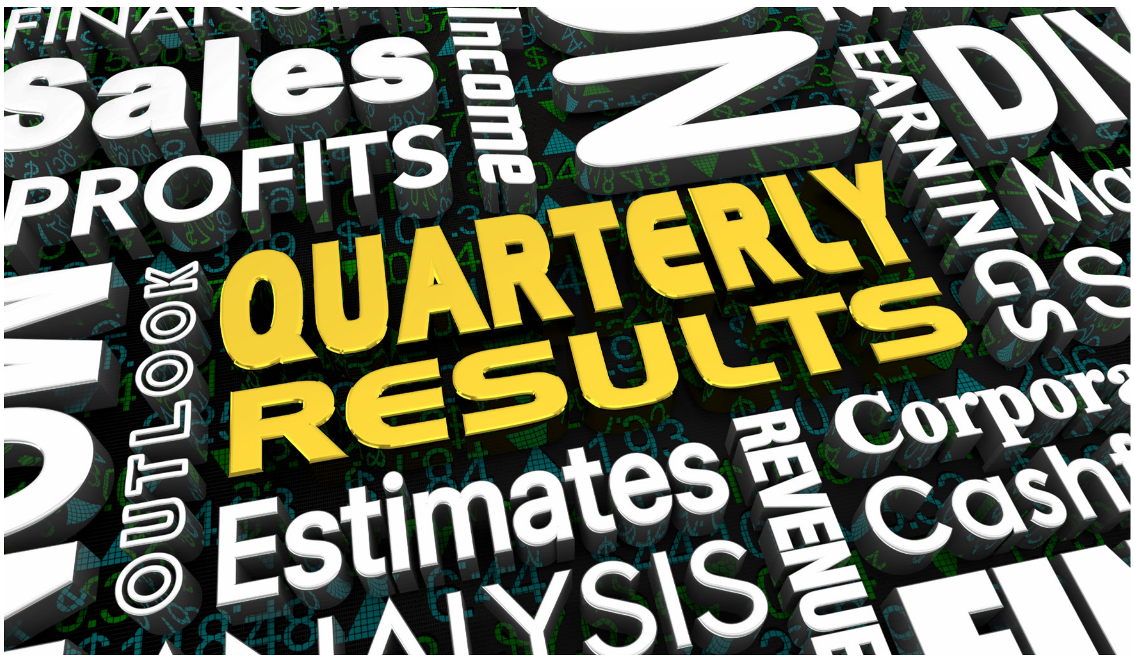

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The capital markets have seen less volatile days. The volatility creates investor fear and uncertainty, something that leads to wild swings in stock prices. Earnings season which is well underway fosters an interesting dynamic for public companies. Good results and/or strong future guidance can send the stock price up or may even result in a modest bump followed by a bit of a sell-off, while bad results can annihilate a stock price and cut it by 35%-50% depending on how bad investors perceived the overall results or future guidance.

Typically, swings in stock price come on the heels of an earnings release. Public companies are required by the SEC to file periodic reports (i.e., Form 10-K and 10-Q's) by specified deadlines dictated by Company filing status (i.e., large accelerated filer, non-accelerated filer, etc.). Even though such periodic reports would be sufficient to provide the market with the necessary financial information provided in these reports and even though an earnings release is not a required public company disclosure, a combination of factors - including market demand, investor expectations and liability concerns - have made the earnings release a mainstay for public companies.

Given the potential havoc that an earnings release may create for a Company's stock price, one may assume a public company might forego them altogether, but investor expectations and a desire by companies to provide context around the financial story have solidified their place in the public company disclosure regime. As a result, the SEC has adopted certain rules surrounding earnings releases even though they continue to be voluntary. Certain rules also impact the content of an earnings release. A good public company should know and understand the rules to ensure compliance and avoid unnecessary confusion from their investors.

Earnings Release: What is all the fuss?

As noted, an earnings release provides companies with a chance to contextualize their financial results in plain language. In addition to a basic presentation of the actual financials, the earnings release (coupled with the earnings call) allows companies to tell investors about business and operational updates, strategic initiatives (both long-term and short-term), provide pipeline information regarding potential future customers and revenue streams and provide future outlook and guidance. Companies will often use the earnings call to outline for investors market opportunities, new product development, sales gains, workforce updates and recent wins. The other intrinsic benefit is the ability to explain losses and provide context and strategic responses to operational challenges or company setbacks in the hope of helping investors to understand (and ideally convince them to not dump the company stock). The difficulty here is that companies must avoid misleading statements and ensure the financial disclosures are accurate and balanced. This means balancing confidence about the future while providing investors with accountability and transparency simultaneously. As

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a result, the development of the earnings call script has become a critical component in a company communication strategy. Collaboration with investor relations, marketing and legal ensures a company can walk this line.

Rules related to the Earnings Release: The basics

A few key SEC rules apply to the earnings release issuance and failure to comply can be problematic and may draw unwanted attention from the SEC, so it is important that companies briefly review them in connection with each release to ensure compliance.

Item 2.02 of Form 8-K: This is the most basic rule. Effectively, it simply mandates that if a company voluntary issues an earnings release, they are required to file the release on Form 8-K. This is because an earnings release includes conveying material non-public information for a completed fiscal period thereby triggering the Item 2.02 disclosure. A separate 8-K is not required for oral information conveyed during the actual earnings call so long as companies (i) issue the 8-K with earnings release as an exhibit and hold the earnings call within 48 hours of the release, (ii) post to the company web site any financial or statistical information that is presented on the call but not included in the earnings release, (iii) tell investors on the earnings call where on the Web site the earnings call slide deck can be found and (iv) post such slide deck in advance of the earnings call.

Regulation FD: This SEC regulation requires public companies to disclose material non-public information to ensure investors have equal access to the company's material disclosures at the same time. While the Form 8-K already discussed helps to address compliance with Regulation FD, the SEC also recommends that companies post a replay or transcript of the earnings call on its website for a reasonable period of time following the earnings call.

Section 21E of the Securities Exchange Act: Section 21E is a safe harbor related to the company's forward-looking statements. Companies should include a forward-looking statement disclaimer in their earnings release that accomplishes the following: (i) provide specific, rather than general, information about the content of the forward-looking statements (e.g., statements about the ability to meet outlined milestones, statements regarding the timing of revenue, etc.), (ii) label the forward-looking statements section with appropriate heading, (iii) include conditions or factors that could cause results to differ materially from those projected and (iv) include a disclaimer providing that the company has no duty to update any statement made in the earnings release. Companies should just remember that even if the "no duty to update" disclaimer is included, if a company learns that a statement they previously made is clearly and materially false, companies should consider issuing an updated statement or clarification as necessary.

Regulation G and Item 10(e) of Regulation S-K: These rules are all about non-GAAP financial measures and this is a hot button topic for the SEC. Regulation G is the regulation that requires a presentation of the most directly comparable GAAP measure and a reconciliation of each non-GAAP measure to the comparable GAAP measure. Item 10(e) has a number of requirements including (i) providing an equal or more prominent presentation of the most directly comparable GAAP measure including in headlines, bulleted lists and charts (i.e., the "equal or greater prominence" requirement); (ii) adding a quantitative reconciliation of each non-GAAP measure to the comparable GAAP measure, (iii) statement of reasons why management believes each non-GAAP measure provides useful information to investors and (iv) statement of additional purposes (if material) for which management uses each non-GAAP measure.

Bringing it together: context and compliance

With the right team engaged on each earnings release, a company can ensure that they are meeting the multiple goals of providing the context they desire to investors while ensuring compliance with SEC rules and regulations. This delicate balancing act helps ensure investors are receiving a message that is clear and transparent and hopefully convinces investors to stay invested even in times of turmoil. Ideally, this goal is accomplished while simultaneously ensuring compliance with SEC rules and providing the company with valuable legal protections.