COVID-19: Earnings Guidance Implications

MARCH 2020

Overview

- **The COVID-19 outbreak has quickly and suddenly devastated many businesses and disrupted the longest running period of economic stability and prosperity in modern U.S. history**
- **Settled expectations for a promising business climate in 2020 have been replaced with uncertainty**
- **Earlier in the year many listed companies issued earnings guidance that did not account for the impact of COVID-19**
- **Following the rapid expansion of the COVID-19 outbreak, certain listed companies elected to revise downward, or withdraw entirely, previously issued earnings guidance in an off-cycle release prior to releasing earnings for the current fiscal quarter; other listed companies are evaluating whether and when to take similar action**
- **This presentation is intended to serve as a resource for listed companies that have issued earnings guidance that no longer aligns with management's expectations**

Basic Legal Framework

- **The Securities Act of 1933 and the Securities Exchange Act of 1934 expressly provide that there is no affirmative duty to update a forward-looking statement**

- **Customary earnings guidance released by a public reporting company constitutes a "forward-looking statement" under the Private Securities Litigation Reform Act of 1995 and, in most instances, will be entitled to the protections of the safe-harbor provisions of the PSLRA**

- **Under the PSLRA safe-harbor there is no liability for a forward-looking statement in a private action for securities fraud if:**
  - the forward-looking statement is identified as forward-looking and accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement,
  - the forward-looking statement is immaterial, or
  - the plaintiff fails to prove that the forward-looking statement was made with actual knowledge that the statement was false or misleading,

  in each case subject to the exceptions outlined on the following slide

- **If the PSLRA safe-harbor is not available, the common law "bespeaks caution" doctrine may provide similar protection**

Basic Legal Framework

- **The protections afforded by the PSLRA safe-harbor do not extend to:**
  - any forward-looking statement that is (i) included within GAAP financial statements, (ii) issued by an investment company, (iii) made in connection with a tender offer, IPO or certain beneficial ownership reports (e.g., Schedule 13D) or (iv) related to partnerships, limited liability companies or direct participation investment programs
  - any issuer that (i) has been convicted of certain felonies or misdemeanors or has been the subject of certain decrees or orders involving the antifraud provisions of the securities laws, (ii) makes the forward-looking statement in connection with an offering of securities by a blank check company, a roll-up transaction or a going private transaction or (iii) issues penny stock

- **Furthermore, certain courts have recognized a duty to update disclosure that subsequently becomes materially misleading or inaccurate, at least in certain circumstances:**
  - In re IBM Corp. Securities Litig., 163 F.3d 102 (2nd Cir. 1998) (finding that "a duty to update may exist when a statement, reasonable at the time it was made, becomes misleading because of a subsequent event," but that there is "no duty to update vague statements of optimism or expressions of opinion")
  - In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3rd Cir. 1997) (finding that although a duty to update may exist where a projection involved “an implicit factual representation that remained ‘alive’ in the minds of investors as a continuing representation” or “a fundamental change in the course the company is likely to take,” there is no duty to update ordinary "run of the mill" earnings forecasts)

- **In contrast, other courts have declined to recognize a general duty to update disclosure:**
  - Gallagher v. Abbott Laboratories, 269 F.3d 806 (7th Cir. 2001) (explaining that securities laws “do not require continuous disclosure” and finding no duty to update forward-looking statements, since “firms are entitled to keep silent . . . unless positive law creates a duty to disclose”)
  - Higginbotham v. Baxter Intern. Inc., 93 495 F.3d 753 (7th Cir. 2007) (holding that the securities laws may require a duty to correct disclosures false when made but not a duty to update disclosures by adding the latest information)

Considerations in Light of the COVID-19 Outbreak

- **Listed companies may consider issuing updated disclosure to adjust, or withdraw entirely, previously issued earnings guidance as a means to:**
  - re-calibrate investor and analyst expectations in light of the present business climate and outlook
  - lessen future volatility in the company's stock price
  - maintain positive relations with investors, customers and other constituents
  - respond to questions in a Regulation FD compliant manner

- **Deciding whether and when to update previously issued guidance will depend on the facts and circumstances facing each company**

- **Factors to consider in deciding whether to update previously issued guidance include:**
  - the extent to which the prior earnings guidance no longer aligns with management expectations
  - whether the impact of the COVID-19 outbreak on the company is obvious and well-publicized
  - the extent to which the prior earnings guidance has effectively been updated, indirectly, by subsequent disclosures, including announcements regarding closure of key facilities, workforce reductions and/or curtailment of operations generally
  - the extent to which consensus earnings estimates have been appropriately adjusted to align with management's latest expectations
  - whether the company (or company insiders) expect to purchase, sell or otherwise transact in securities of the company
  - whether non-routine matters will be subject to a vote of shareholders
  - whether the company has established a clear pattern of updating guidance on prior occasions
  - whether, at the time the earnings guidance was released, the company expressly indicated that it would (or would not) provide

Other Considerations When Updating Guidance

- **Regulation FD**
  - To comply with Regulation FD, any update, confirmation or withdrawal of earnings guidance should be made by means that constitute widespread, non-exclusive "public disclosure"
    - For example, a Form 8-K or press release distributed through a widely disseminated news or wire service
  - Companies should adhere to a "no comment" policy in response to questions regarding earnings guidance updates or confirmations

- **Serial Earnings Guidance Updates**
  - The widespread uncertainty caused by the COVID-19 outbreak presents a challenging backdrop for any management team tasked with re-forecasting 2020 results
  - In this dynamic environment, a complete withdrawal of earnings guidance (as opposed to a specific downward adjustment) offers the advantage of side-stepping these additional forecasting challenges
  - If earnings guidance is updated by way of a specific downward adjustment, companies should regularly compare that guidance against management's latest expectations
    - If material differences exist, further guidance updates should be considered

Other Considerations When Updating Guidance

- **Item 2.02 of Form 8-K**
  - If an earnings guidance update is issued after the close of a fiscal period and the communication includes MNPI regarding the company's results of operations or financial condition for the recently completed period, a Form 8-K will be required to be furnished under Item 2.02(a)
  - The use of non-GAAP measures in a Form 8-K under Item 2.02(a) is subject to heightened requirements (including the rules concerning equal or greater prominence)

- **Securities Offerings and "Offers"**
  - If the company does not have a registration statement on file with the SEC and plans to conduct a securities offering subject to the "gun jumping" provisions of the Securities Act close in time to a guidance update, the update may be considered an impermissible "offer" in violation of Section 5 of the Securities Act
    - Rule 168 provides a safe harbor for regularly released forward-looking information (including earnings guidance) if the release does not contain information about the offering, the release is not part of the offering process and the timing, manner and form of the release is consistent in material respects with similar past releases
  - If the company plans to engage in a securities offering and it has previously issued earnings guidance that is no longer accurate, the disclosure requirements (and associated liability provisions) of the securities laws need to be considered
    - Determining if any yet to be released financial results will "surprise" the market will be a central focus

Potential Approaches Available

- **The first regularly scheduled opportunity to update or withdraw previously issued guidance will coincide with the release of Q1 earnings**

- **In certain cases, however, it may be prudent and advisable to issue an off-cycle guidance update in advance of releasing Q1 earnings**

- **The specific course of action taken should be influenced by the applicable facts and circumstances; the range of possible actions include:**
  - Withdrawing Q1, Q2 and/or FY 2020 guidance due to the unpredictable impact of COVID-19
  - Forecasting the impact of COVID-19 on Q1 (and possibly Q2), but excluding the impact from revised guidance for the balance of FY 2020
  - Adopting a “no comment” policy with respect to updating previously issued guidance generally
  - For companies that typically release earnings guidance each quarter, discontinuing the practice of providing earnings guidance altogether

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