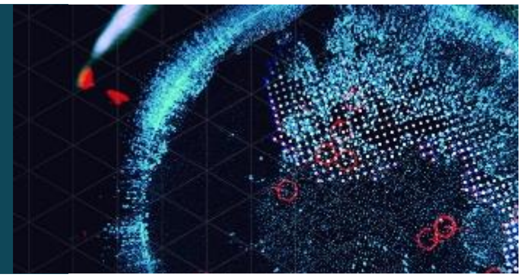
Coronavirus/COVID-19

Managing COVID-19: Whether to Announce Preliminary Financial Results and Adjust Guidance



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The COVID-19 pandemic and its economic consequences have spurred a tremendous amount of market volatility, and many public companies can expect questions from shareholders and analysts regarding the effect of these factors on companies' current and future operations and liquidity. The uncertainty of the pandemic's duration and impact on the economy may lead some companies to stay silent until the next regularly scheduled earnings announcement. However, some companies may consider announcing preliminary financial results in advance of their regularly scheduled earnings release date, either to reassure the market and shareholders as to the operating performance and financial position of the company, or to alert shareholders about the likelihood that actual results will fall short of previously disclosed guidance. Further, companies that have disclosed guidance, and particularly quarterly guidance, may also consider whether it is appropriate to withdraw or update such guidance given the unprecedented economic dislocation brought about by the COVID-19 pandemic. This client alert discusses key considerations for companies navigating these issues.

We note also the recent guidance issued by the Financial Conduct Authority ("FCA") for UK-listed companies. This guidance seeks a two-week moratorium on issuing preliminary results. The FCA's action underscores the critical importance of ensuring the accuracy of any preliminary earnings information disclosed to shareholders and the markets.

1 Why would a company want to announce preliminary financial results?

Answer: The U.S. financial markets continue to experience significant volatility in the wake of the COVID-19 pandemic, and many companies have seen dramatic decreases in the market value of their securities. This has led to concern in the market about the operations, short-term viability and long-term prospects of otherwise healthy companies. In some circumstances the early announcement of preliminary financial results for the quarter could help mitigate investor concerns by affirming management's expectations regarding the company's financial performance and future plans in the current challenging business environment.

On the other hand, companies whose operations and results have been adversely affected by the COVID-19 pandemic and related economic consequences may consider announcing preliminary financial results if they conclude that such results are likely to be materially below the company's previously issued guidance or the clear consensus of analysts.

2 Do I need to issue a Form 8-K to announce preliminary financial results?

Answer: If the period that is the subject of the preliminary financial results has been completed, yes. Item 2.02 of Form 8-K is triggered by the release of material, nonpublic information concerning a completed fiscal period rather than one in progress or yet to come.

An announcement of preliminary financial results after the end of the period but before the ordinarily scheduled date for the earnings release triggers the Form 8-K requirement of Item 2.02. Since Item 2.02 Form 8-Ks are considered furnished rather than filed under SEC rules, absent disclosure to the contrary, a Form 8-K containing preliminary financial results will not be incorporated by reference into any registration statements. In addition, if an announcement includes a non-GAAP financial measure the discussion of the measure must comply with Item 10(e) of Regulation S-K in the same manner as a traditional earnings release, including disclosing the most directly comparable GAAP measure with equal or greater prominence to the non-GAAP measure, discussing the reasons why the company uses the measure and providing a reconciliation to the most directly comparable GAAP measure.

If a company announces estimated or expected financial results for a period before the end of that period, an Item 2.02 Form 8-K is not required. Instead, such disclosure could be provided through any means that complies with Regulation FD, such as a widely disseminated press release or a Form 8-K that is furnished under Item 7.01 or filed under Item 8.01.

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3 What specific financial information is provided in an announcement of preliminary financial results?

Answer: Generally, companies choosing to provide preliminary financial results will do so only for a limited set of financial metrics (whether specific amounts or a limited range), such as net sales/revenues, and non-GAAP metrics such as adjusted EBITDA. A common approach is to include the preliminary financial results in a press release together with a statement from the company’s CEO and forward-looking statement safe harbor language. Absent compelling reasons, companies should generally avoid deviating from established timing for dissemination of guidance.

Furthermore, disclosure of preliminary financial results should make very clear that the results are preliminary and subject to change in connection with the completion of the financial statements and the quarterly review process by the company’s auditors. If there are material changes when results are finalized, those changes should be disclosed in the company’s earnings release. Given the potential market disruption associated with errors in preliminary financial results, companies generally defer disclosure of such results until there is sufficient certainty that the results are unlikely to change, or are unlikely to change outside a limited range, which may be disclosed in lieu of specific results.

In light of the challenges presented by COVID-19, such as wide-scale remote working and the potential illness or unavailability of key persons in the reporting process, companies preparing to pre-announce earnings should assess the status of their internal controls to ensure that they will provide reasonable assurance regarding the accuracy of the information being reported.

4 Should companies conduct investor conferences or shareholder meetings prior to, or subsequent to, announcing preliminary financial results for a recently completed fiscal period?

Answer: Investor conferences or shareholder meetings that are not conducted in a Regulation FD compliant manner present risks. If there is concern that all of the material non-public information about the financial period has not been disclosed, companies should avoid meeting with investors in a non-Regulation FD compliant manner prior to the scheduled earnings announcement in order to avoid the need for additional interim disclosures concerning the preliminary financial results.

5 Can companies or their insiders conduct securities transactions when considering announcement of preliminary financial results?

Answer: Companies and their insiders may not engage in securities transactions, including offerings and buybacks, if they are in possession of material non-public information or if the company has not fully disclosed all information necessary to make its existing disclosures not misleading. In this regard, the SEC staff recently provided guidance that if a company is aware of a risk related to COVID-19 that would be material to investors, the company and its insiders should refrain from engaging in securities transactions until the risk has been disclosed to investors.

Accordingly, announcements of preliminary results must provide enough information, including with respect to material risks presented by COVID-19, to ensure that the company and its insiders no longer possess material non-public information when they trade in company securities.

6 When should companies that are announcing preliminary quarterly financial results consider updating previously issued annual guidance?

Answer: As a general rule, companies do not have a duty to update forward-looking statements. However, when a company's previously issued forward-looking guidance becomes misleading or inaccurate, a company should consider whether disclosure correcting, revising or updating the prior forward-looking guidance is warranted. Companies facing the prospect of reporting quarterly results below the previously issued guidance range often consider whether to lower full-year guidance as part of the preliminary financial results announcement or formal earnings announcement. If management believes results may improve in subsequent quarters or the company's earnings visibility is too limited to justify a change, management often decides to maintain full-year guidance. However, companies often consider updating forward-looking guidance in order to maintain credibility and mitigate surprises and litigation risk.

There are several factors that should be considered in determining whether previously issued guidance should be updated or withdrawn. These considerations can include company policies for issuing and updating guidance, any public statements it has made in this regard, alignment between internal financial expectations and publicly disclosed guidance and the precedential effect of updating guidance outside the company's routine schedule.

Next, consider the facts and circumstances that have changed since the prior guidance was issued. If the original guidance had a clear explanation of the assumptions used, consider whether recent events have developed in a way that the investment community can reasonably recognize that one or more of those assumptions are no longer correct. One aspect of this analysis includes whether analysts and the street have already updated their estimates. In addition, we suggest considering whether the company will be able to speak truthfully to analysts and the investment community in the interim if it does not update its guidance.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Securities and Capital Markets practice:

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