New Investors: How to Effectively Review an Earnings Report

Description

When a company releases an earnings report, there's a lot of useful information that investors can obtain from it. Many times, the focus is strictly on profits and revenues, and whether the company beat Wall Street's expectations. However, that can distract investors from more important information, and that's why it's always important to look at a company's financials yourself, particularly if you're considering investing in the stock.

I'll go over the main areas of a company's earnings report that you should look at to help assess its overall performance.

CEO's letter

In earnings reports, you'll normally see a letter from the company's CEO, which gives investors a high-level overview of how the quarter went, what might be ahead, and industry-related issues that may provide a bit more context as well. It's a good starting point to skim through if you want to get a rough idea of where the company is today and the challenges it is facing.

Outlook and guidance

In some cases, a company's outlook for the upcoming quarter can have more of an impact on its share price than how it actually performed in the most recent quarter. If a company anticipates a soft quarter ahead, then that can send investors into a panic and lead to a sell-off, as concerns could be raised about growth and long-term potential.

This section will also give you insight into what economic or industry-related issues may impact the company in the future.

Avoid adjusted earnings and go straight to the "real" financials

The danger with looking at an adjusted earnings calculation is that the figure is non-GAAP, and it can offer managers a lot of discretion as to what gets included and what doesn't. For example, whether an expense is related to mergers and acquisitions and whether it isn't can often be a fine line, and that can have a big impact on adjusted earnings. The argument can also be made when looking at companies that are always in acquisition mode, like **Cara Operations Ltd.** (TSX:CARA) and **Alimentation Couche-Tard Inc.** (TSX:ATD.B), that maybe those expenses could be considered recurring and shouldn't be excluded, even in an adjusted calculation.

Rather than looking at adjusted earnings, investors should go straight to the company's income statement and balance sheet, which will provide more consistency, especially when comparing one company to the next. While there may be differences like tax recoveries and benefits that can skew the results, that's ultimately where the management discussion and analysis (MD&A) comes into play.

Management commentary

The MD&A section should give investors sufficient information about what happened in the quarter relating to variances, abnormalities, and any other things that potential shareholders should know about. This can be very extensive, and so if you're strapped for time, you'll want to look at the financials first, identify variances, identify any corresponding notes to the variances, and then focus on those specific notes, so you don't end up reading a novel.

Bottom line

Earnings reports will vary from one company to the next, but there is a lot of useful information that investors can easily miss by just relying on the headlines and whether a company met its expectations or not.

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