

BETWEEN THE LINES

October 12, 2018

Helping All-Stars Bring Their Q&A-Game

Introduction

A year has passed since we last examined some of the questions asked by Wall Street's top-rated analysts during quarterly earnings calls. Even the best analysts do not always ask the best questions, and we believe they could benefit from our question formulation expertise. At BIA, we coach and advise our clients how to interview executives and determine the completeness, accuracy and reliability of the information they provide using our proprietary Tactical Behavioral Assessment® (TBA™) methodology. In this edition of *Between the Lines*, we break down questions from a randomly selected sample of top analysts to show how BIA's approach to asking questions could have helped them gain more insight from management teams.

Be Careful What You Wish For

"And Michel, if there isn't anything to do in the U.S. and leverage is dipping below Altice USA's sort of target level, are there opportunities in Europe to maybe dividend cash up to N.V. and deploy through accretive acquisitions outside the United States?"

- Benjamin Swinburne, Morgan Stanley. Altice N.V., Q2 2017 Earnings Call

This is an example of a closed-ended question. These questions can be powerful when used correctly because they make it clear exactly what response is expected. However, these questions present a downside: because they seek a specific answer, they take away the pressure to provide any extra information. In this case, management hears "are there opportunities" and they know that they are expected to answer "yes" or "no" – but they also know they do not have to talk about what opportunities they actually have. For this reason, BIA stresses the importance of asking the question you actually want answered. In this case, that means better formulating a question that encourages management to provide concrete details about their capital allocation priorities.

How management exploits the poorly phrased question:

Management responds to Mr. Swinburne's question by confirming that they have alternative opportunities to use cash outside the U.S., but they do not volunteer any information about the specific actions they are considering.

How BIA would rephrase the question:

- As you look to use some of your excess cash, what sort of opportunities outside of the U.S. do you find most attractive?
- If you do not find any good opportunities in the U.S., how are you most likely to deploy your cash outside of the U.S.?
- Where do you have the most opportunity to deploy excess cash outside of the U.S.? The least?

Twice the Question, Half the Answer

"You mentioned there was a timing issue in SG&A. Could you quantify how much that helped SG&A or how much we should expect it to come in, in the second quarter?"

- Gregory Melich, Evercore ISI. Target Corp., Q1 2017 Earnings Call

Sometimes, the simplest questions can be the most effective. Mr. Melich tries to ask management to quantify the impact of SG&A timing, but he asks his question in two different ways. Compound questions like this one give management the chance

to choose which part they want to address, allowing them to avoid unfavorable questions and provide an incomplete answer. BIA advises asking questions individually in order to elicit the specific insight that interviewers are seeking.

How management exploits the poorly phrased question:

Management touches on both parts of Mr. Melich's question, but answers neither. They use a vague, qualified statement about Q2 to avoid quantifying the SG&A impact in either Q1 or Q2.

How BIA would rephrase the question:

- We understand that timing can temporarily affect results now and then. What was the impact of SG&A timing in Q1?
- To what extent do you expect SG&A to be impacted by timing in Q2?
- What is the most you expect to spend on SG&A in Q2? What is the least?

How to Make Friends and Elicit Insight

"Hate to put you on the spot, but like to get any update on succession planning, potential timing. I know you just can't bear the thought of not coming down on Sarasota."

- Charles Stephen Tusa, JPMorgan Chase. General Electric Co., Electrical Products Group 2017 Annual Spring Conference

Adding a prologue to a question is an effective strategy to lower a management team's defenses and increase the likelihood that they provide the desired insight. Mr. Tusa tries to do this when he begins his question by telling management he "hate[s] to put you on the spot." However, by saying he does not want to put them on the spot, "but," Mr. Tusa inadvertently signals to management that he is trying to set aside their sensitivity to the question, rather than trying to understand and accommodate it; this has the effect of raising, not lowering, their defenses. In order for a prologue like this to be successful, it needs to give the impression that the analyst is not being critical or judgmental of the management team.

How management exploits the poorly phrased question:

Management does not answer with any concrete insight into the question, but instead tries to minimize investors' concerns about the succession-planning process.

How BIA would rephrase the question:

- Understanding that you have a deep bench, what are the most important qualities the Board is looking for in potential successors?
- We are glad to know that the Company has been working on this process for a long time. When is the soonest you could complete your succession-planning process? The latest?
- It is reassuring to hear that you have a disciplined succession-planning process. Which aspects of the process are likely to take the longest to complete?

Catch More Flies with Honey Than with Vinegar

"Wanted to go back to the top line organic sales growth, so the 4% that you mentioned for 2018. Back in November 16, you said 4% to 6% long term. I guess do you wish you'd said 3% to 5% longer term?"

- Ali Dibadj, Bernstein. Coca-Cola Co., Q4 2017 Earnings Call

Although Mr. Dibadj's question is intended to gauge management's confidence in their long-term guidance, it does not give them the freedom to provide a candid response. If their answer is "no," it is easy for them to say so. However, by asking whether they regret guiding as they did, Mr. Dibadj puts them in a position where answering "yes" would force them to admit that their guidance was a mistake. Therefore, the question adds an extra psychological barrier that incentivizes them to withhold unfavorable insight. Questions must be not only clear and concise, but also fair; BIA would recommend asking this question in a way that makes it easier, not more difficult, for management to volunteer information they would otherwise want to conceal.

How management exploits the poorly phrased question:

Management interprets the question as an attempt to trick them into revising their guidance, causing them to focus on the positive aspects of their outlook instead of discussing any concerns they might have.

How BIA would rephrase the question:

- What concerns you the most about your ability to achieve your long-term organic sales growth targets?
- Since you provided your long-term organic sales growth outlook of at least 4%, what challenges have arisen that would make that more difficult to achieve?
- What is the likelihood that your long-term organic sales growth trends below 6%? 5%? 4%?

A Whole Spectrum of Color Questions

“I guess, Dick, any additional color maybe regarding trends you’ve seen in May versus that 1Q performance by concept?”

- Matthew Robert Boss, JPMorgan Chase. Urban Outfitters, Inc., Q1 2019 Earnings Call

“Perhaps first, Paul, Joe, how are you thinking about the \$5 billion maturities in 2020?”

- Umer Raffat, Evercore ISI. Valeant Pharmaceuticals International, Inc., Q2 2017 Earnings Call

“Steve, with respect to filling Franz’s spot in Vacation Ownership, can you talk about the progress in that search?”

- Joseph Greff, JPMorgan Chase. Wyndham Worldwide Corporation, Q4 2016 Earnings Call

Whether asking for “any additional color” and something to “talk about” or asking “how are you thinking,” analysts often rely on questions like these. While open-ended questions can prove useful in certain situations, making them too broad and vague allows management teams to focus only on the most positive aspects of an issue and avoid addressing any negative aspects. At the same time, the lack of a clear behavioral stimulus can obscure the precise implications of their behaviors. BIA’s question formulation strategy teaches that interviewers should craft questions that specifically target the most critical pieces of information they are missing on a specific issue.

How management exploits the poorly phrased question:

In each of these examples, the insight management provides is incomplete, as a result of either ignoring certain parts of the question or leaving out important information they would be expected to share.

How BIA would rephrase the question:

- What are your specific plans to manage your \$5 billion of maturities in 2020?
- Which of your concepts trended most favorably in May relative to Q1? Which concepts trended least favorably?
- When is the earliest you expect to fill Franz’s place in Vacation Ownership? When is the latest?

About this Report:

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