

BETWEEN THE LINES

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Is That the Question? Common Pitfalls and How Not To Ask Questions

Introduction

As we close out this year's first earnings season, we look back at some of the most consistent flaws in question formulation we observed in our analyses of quarterly earnings calls during 2024. Each year, we look at thousands of question-and-answer exchanges and 2024 was no exception in terms of discovering poor questions from analysts. In this edition of Between the Lines, we apply our proprietary Tactical Behavior Assessment® (TBA) methodology to examine some examples of questions that feature common pitfalls we see analysts fall prey to. And while all these examples come from quarterly earnings calls, the principles apply to any context in the investment community, including private settings. We see a lot of questions from analysts that just make our heads spin. Below are examples from 2024 earnings calls that illustrate some of the typical mistakes analysts make when asking questions of executives and management teams. We also introduce some sample "Question Prologues" and suggest more effectively formulated questions supplied by our TransparencyAI automated offering.

If you lead, they will follow.

Question: "And then given that 270 benefit, it suggests that there is an underlying rate of revenue growth that's high single digits. Would that be a reasonable expectation for the balance of the year? And in that scenario, given some operating leverage, would you expect to be able to deliver organic operating margin expansion?" – *Deutsche Bank, AG on Heineken, NV Trading Call*

BIA's Critique: This question is phrased in a way that telegraphs to management what the analyst is expecting or wants to hear – that underlying revenue is at a high single-digit growth rate and that the Company will achieve operating margin expansion. However, the analyst asks management to simply confirm this assumption which makes it easy for them to appeal to the analyst's bias and superficially agree with the assumption without truly committing to it (i.e. "Sure, sounds reasonable." or "That's definitely the right way to think about it."). Similarly, it would be easy for management to simply agree that "yes" they could deliver margin expansion but not offer any additional insight should they choose not to do so. BIA recommends that, rather than inadvertently supplying management with answers, investors place the burden of answering questions on management. Clear, direct questions like the ones below are more likely to garner information.

Avoid supplying the answer you want to hear.

In certain circumstances, BIA suggests leading with a "Question Prologue" – a series of statements designed to lower management's defensiveness, pre-emptively head off potential obfuscation or excuses for not providing a direct answer and enhance the effectiveness of a well-formulated question. Below is one approach you could take.

BIA's Question Prologue Suggestion: *Given the 270 benefit you will get, it looks like you could improve the underlying rate of revenue growth this year. That could certainly lead to improvements in operating leverage as well. In the current macroeconomic environment, it is understandable that your expectations for revenue and operating leverage could shift a bit in upcoming quarters and so...*

Next, you want to ask your question in a clear, concise way. BIA's TransparencyAI offering provides clients with annotated transcripts that identify, rate, and explain behavioral red flags and suggests well-formulated questions to address those topics. Below is a suggestion for simple questions TransparencyAI provided to help focus management's response to this topic.

BIA's TransparencyAI Question Suggestion:

- ...*What obstacles to revenue growth are you expecting in the remainder of the year?*
- ...*To what extent are you expecting operating margin contraction for FY 2024?*
- ...*What could cause operating margin to decline next year?*

If they can opt out, they won't necessarily opt in.

Question: "It seems you're making a comment in the press release that you're looking at improving the conversion of free surplus generation to cash at the group. Could you possibly elaborate on this? And at what point do you think you'll be able to move up or away from your DPS growth target? ... So anything you can say on that would be helpful." – *JPMorgan Chase & Co. on Prudential, PLC. Earnings Call*

BIA's Critique: The phrases "could you possibly elaborate" and "anything you can say" give management a great deal of latitude to offer irrelevant information rather than address the specific issues and an easy out to simply decline to answer the question should they choose to do so. BIA recommends that investors formulate questions that subtly, but fairly, place psychological pressure on an interviewee to disclose information. By phrasing the question in a way that presumes there will be challenges, investors will be more likely to obtain useful insight into whether management has concerns about their ability to convert free cash and improve dividends. The questions below can be readily answered by executives who have nothing to hide but also make it difficult for executives who have concerns to dodge them.

**Avoid asking for
"anything you can say ..."**

BIA's Question Prologue Suggestion: *It is great to hear that you are looking to improve the conversion of free surplus generation to cash at the group level. You have been successful in the past in making these kinds of improvements even as others in the industry have also struggled to do so. Understanding that improving free cash flow conversion is not always a simple thing...*

BIA's TransparencyAI Question Suggestion:

- ...*What are the biggest challenges to improving the conversion of free surplus generation to cash?*

My, my, my, my. What a mess.

Question: "Yes, this has been somewhat addressed, but I think I'd maybe be a little bit more specific. The stock is off a bit premarket on what appears to be around 2025 earnings growth given your outlook for FX and net interest expense going into next year. And I think the lesson from this year, and really in recent years, has been your ability to overcome these substantial [FX] headwinds and other headwinds and still deliver on reported EPS growth. You both expressed some confidence in the prepared remarks on innovation, delivering against longer-term targets. So I guess, can you just touch on maybe some of the lessons of 2024 areas which really allowed you to overcome what was a substantial FX, it still is, headwind this year and still deliver your reported earnings objective, whether pricing, RGM, innovation, whatever that may be? And what feels durable going into next year? I know you've touched on it, but just trying to get down to what's really driving the stock today. And then maybe importantly, then I'm done. But just the areas where you have a bit more of a heightened focus or a sense of things? Maybe slowing in Mexico, India, some of these lingering turbulent issues in the Middle East, anything that comes to mind? So

basically, just you've got momentum into confronting these headwinds next year, but the environment is also evolving. And I'd just maybe like to put a little bit of a finer bow on that.

Management's Response: Sure. I think you're going to win this year's prize for the longest question... – *Wells Fargo Securities, LLC on Coca-Cola Company, Earnings Call*

BIA's Critique: Management is on to something here. This question is long, convoluted, multipart and vague. To be fair, it starts off with elements of a BIA Question Prologue. The statements "the lesson...has been your ability to overcome these substantial effect headwinds...still deliver on reported EPS growth. You both expressed some confidence in...delivering against longer-term targets" signal that the analyst is not being judgmental or critical and is optimistic about the Company's future. This invites management to more easily share information. However, the subsequent string of questions eliminates that psychological impact. Asking so many questions at once is overwhelming and can be confusing for even the most forthcoming executives. It also makes it unclear what the analyst really wants to know, making it hard to determine, for both the analyst and management, if the question has been fully answered. Furthermore, phrases such as "can you just touch on," "a sense of things" and "anything that comes to mind" give management leeway to respond vaguely and gloss over topics they want to avoid. Below are examples of how BIA would suggest approaching this topic.

"You're going to win this year's prize for the longest question..."

BIA's Question Prologue Suggestion: *You have demonstrated that you can handle issues such as FX headwinds and still deliver earnings and it sounds like you are confident in delivering against long-term targets. Understanding that you have gained momentum in 2024 confronting these headwinds, the environment is evolving and so...*

BIA TransparencyAI Suggestion:

- ...What headwinds are you expecting to get worse next year?
- ...What changes are you considering making to your strategy for 2025?

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