

The Effect of Size on Growth: Callaway Golf

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Year	Net Profit	Growth Rate
1990	1.80	
1991	6.40	255.56%
1992	19.30	201.56%
1993	41.20	113.47%
1994	78.00	89.32%
1995	97.70	25.26%
1996	122.30	25.18%

□ Geometric Average Growth Rate = 102%

Extrapolation and its Dangers

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Year	Net Profit
1996	\$ 122.30
1997	\$ 247.05
1998	\$ 499.03
1999	\$ 1,008.05
2000	\$ 2,036.25
2001	\$ 4,113.23

- If net profit continues to grow at the same rate as it has in the past 6 years, the expected net income in 5 years will be \$ 4.113 billion.

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Growth II

Analyst Estimates

Analyst Forecasts of Growth

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- While the job of an analyst is to find under and over valued stocks in the sectors that they follow, a significant proportion of an analyst's time (outside of selling) is spent forecasting earnings per share.
 - ▣ Most of this time, in turn, is spent forecasting earnings per share in the next earnings report
 - ▣ While many analysts forecast expected growth in earnings per share over the next 5 years, the analysis and information (generally) that goes into this estimate is far more limited.
- Analyst forecasts of earnings per share and expected growth are widely disseminated by services such as Zacks and IBES, at least for U.S companies.

How good are analysts at forecasting growth?

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- Analysts forecasts of EPS tend to be closer to the actual EPS than simple time series models, but the differences tend to be small

Study	Group tested	Analyst Error	Time Series Model Error
Collins & Hopwood	Value Line Forecasts	31.7%	34.1%
Brown & Rozeff	Value Line Forecasts	28.4%	32.2%
Fried & Givoly	Earnings Forecaster	16.4%	19.8%

- The advantage that analysts have over time series models
 - tends to decrease with the forecast period (next quarter versus 5 years)
 - tends to be greater for larger firms than for smaller firms
 - tends to be greater at the industry level than at the company level
- Forecasts of growth (and revisions thereof) tend to be highly correlated across analysts.

Are some analysts more equal than others?

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- A study of All-America Analysts (chosen by Institutional Investor) found that
 - There is no evidence that analysts who are chosen for the All-America Analyst team were chosen because they were better forecasters of earnings. (Their median forecast error in the quarter prior to being chosen was 30%; the median forecast error of other analysts was 28%)
 - However, in the calendar year following being chosen as All-America analysts, these analysts become slightly better forecasters than their less fortunate brethren. (The median forecast error for All-America analysts is 2% lower than the median forecast error for other analysts)
 - Earnings revisions made by All-America analysts tend to have a much greater impact on the stock price than revisions from other analysts
 - The recommendations made by the All America analysts have a greater impact on stock prices (3% on buys; 4.7% on sells). For these recommendations the price changes are sustained, and they continue to rise in the following period (2.4% for buys; 13.8% for the sells).

The Five Deadly Sins of an Analyst

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- Tunnel Vision: Becoming so focused on the sector and valuations within the sector that you lose sight of the bigger picture.
- Lemmingitis: Strong urge felt to change recommendations & revise earnings estimates when other analysts do the same.
- Stockholm Syndrome: Refers to analysts who start identifying with the managers of the firms that they are supposed to follow.
- Factophobia (generally is coupled with delusions of being a famous story teller): Tendency to base a recommendation on a “story” coupled with a refusal to face the facts.
- Dr. Jekyll/Mr.Hyde: Analyst who thinks his primary job is to bring in investment banking business to the firm.

Propositions about Analyst Growth Rates

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- Proposition 1: There is far less private information and far more public information in most analyst forecasts than is generally claimed.
- Proposition 2: The biggest source of private information for analysts remains the company itself which might explain
 - ▣ why there are more buy recommendations than sell recommendations (information bias and the need to preserve sources)
 - ▣ why there is such a high correlation across analysts forecasts and revisions
 - ▣ why All-America analysts become better forecasters than other analysts after they are chosen to be part of the team.
- Proposition 3: There is value to knowing what analysts are forecasting as earnings growth for a firm. There is, however, danger when they agree too much (lemmingitis) and when they agree to little (in which case the information that they have is so noisy as to be useless).