OSLER

Using growth targets to supplement growth strategy disclosure

DECEMBER 13, 2017 8 MIN READ

Related Expertise

- Corporate Governance

Authors: James R. Brown, Rosalind Hunter, Desmond Lee

The increase in initial public offering (IPO) activity in 2017 saw an increase in the use of "growth targets" – forward-looking information about a company's medium- to long-term financial and operating results – to supplement the company's growth strategy disclosure. The quality of a company's growth strategy and management's track record for achieving growth can significantly impact the success of an IPO as well as ongoing share price performance. Institutional investors are demanding more information and a greater level of detail from companies with respect to their growth plans, especially in the case of new public companies. The use of growth targets can be helpful because they quantify the impact of growth plans from management's perspective, providing greater visibility into the company's performance in the future.

Historical approach to growth strategy disclosure

Growth strategies are the actions a company intends to take in order to grow revenues, earnings or other results. Until as recently as 2015, the practice in Canada has been to describe growth strategies only in general terms, without quantifying the potential impact of these strategies on the company's future financial or operating results. This historical approach has its limitations, as it leaves investors and research analysts to determine how a company's growth plans may translate into actual performance in the future without the benefit of management's own views. It may also lead to over-reliance on the company's historical growth rates as a predictor of future results. Historical growth rates may be either lower or higher than anticipated growth rates and may not account for changes to the company's business, such as the implementation of new initiatives and strategies. The use of growth targets to supplement a company's growth strategy disclosure seeks to address these issues, although investors and research analysts still need to apply their own analysis and judgment in evaluating the extent to which a company will achieve its growth objectives.

Growth targets are not the same as guidance

Growth targets, unlike more traditional earnings guidance, are medium- to long-term in nature (typically three, five or seven years in the future), and represent results that a company intends to achieve by a certain time in the future based on its current business plan and strategies. Growth targets are not intended to be a forecast of future results. Growth targets may be provided for different financial measures and operating metrics, such as revenue, sales, net income, EBITDA, adjusted EBITDA, margins, capital expenditures, store openings, same-store sales growth, and even compound annual growth rates for revenue or earnings measures.

Growth targets should not be presented as a year-by-year forecast or year-by-year guidance for the period of time covered by the targets.

Whereas guidance is usually expressed as an estimated range of values for a particular financial reporting period (e.g., "guidance for fiscal 2018 revenue is in the range of $525 to $550 million"), disclosure with respect to growth targets tends to be looser (e.g., "we believe an opportunity exists to grow our annual revenue to between $525 and $550 million by 2022"). In order to avoid regulatory concerns, growth targets must have a reasonable basis and be based on reasonable assumptions. While targets can be aspirational, management and the board of the company must believe they are realistically achievable.

Legal and regulatory considerations relating to growth targets

Growth targets are a form of forward-looking information under Canadian securities laws, and are subject to the same legal and regulatory requirements that apply to all forms of forward-looking information. When using growth targets, the following should be considered:

Format

In Canada, growth targets are usually discussed in the "Outlook" section of the company's management's discussion and analysis (MD&A) or in the growth strategies section of the IPO prospectus, or both. Growth targets are often also summarized in table format in the prospectus cover page artwork and in the roadshow presentation for the IPO. In the United States, growth targets may be provided in the roadshow presentation but not in the registration statement or prospectus itself. The disclosure of growth targets is accompanied by the usual and prescribed disclaimers and cautionary statements for forward-looking information.

Length of target period

The early Canadian examples of growth target disclosure from 2015 used a five- to seven-year period for the company to achieve its target results. However, due to regulatory concerns that targets must be limited to a period for which the information can be reasonably estimated, target periods on recent IPOs have been shorter – typically between three and five years. The Ontario Securities Commission (OSC) has indicated that it may raise comments in respect of the reasonableness of the length of the target period. Accordingly, a company should be prepared to demonstrate that sufficient visibility and predictability exists in its business and industry to warrant using a target period that extends beyond the end of its next fiscal year.

Targets should not be presented as a year-by-year forecast

Growth targets are not intended to be, and should not be presented as, a year-by-year forecast or year-by-year guidance for the period of time covered by the targets. For instance, if a company's goal is to achieve revenue of between $525 and $550 million by 2022, it should not disclose its anticipated revenue in each of 2018, 2019, 2020, 2021 and 2022. The intention is to provide management with adequate "runway" to meet its targets within the specified timeframe using the various elements of the company's growth strategy. Growth may not be linear, and may be higher in some years as compared to other years within the target period. If appropriate, issuers should disclose the reasons for anticipated year-to-year variations and the drivers of growth.

Assumptions underlying growth targets must be stated in detail

Securities regulators in Canada have a preference for numerous and detailed assumptions underlying growth targets. This should include a mix of qualitative descriptions of assumptions and material factors relevant to the targets (including risk factors) and, where appropriate, details as to actual amounts assumed (e.g., assumptions with respect to number of stores to be opened each year, capital expenditures required to achieve the intended growth, foreign exchange rates, etc.). The OSC has indicated that it may ask a company to limit growth targets to a shorter period (for example, one or two years) if the company is unable to sufficiently support its growth targets with reasonable qualitative and quantitative assumptions.

Assumptions underlying growth targets must be reasonable

Securities regulators in Canada have shown a willingness to challenge the reasonableness of assumptions underlying growth targets, particularly in circumstances where the targets and anticipated future growth rates are not supported by the company's historical results and growth rates. Having reasonable assumptions is also important in terms of mitigating potential liability for misrepresentation relating to growth target disclosure. During the comment process, companies must be prepared to explain to the regulator the key drivers of anticipated growth and why the company's growth targets are reasonable. In doing so, companies must refer to the details of their specific business plans and objectives. As part of the comment clearing process, the regulator may require additional disclosure regarding assumptions to be added to the prospectus.

Growth targets are subject to updating obligations post-IPO

Canadian legal requirements relating to forward-looking information require companies, during the period covered by the growth targets, to discuss in their MD&A or in a news release events and circumstances that are reasonably likely to cause actual results to differ materially from previously disclosed growth targets. The expected differences must also be disclosed. Companies must also discuss in their MD&A material differences between actual results achieved as compared with previously disclosed growth targets. Since 2015, practice has been mixed in terms of companies providing regular updates with respect to progress towards growth targets in the absence of a change in outlook or circumstances that would lead management to conclude that a company will not be able to achieve its target results. While we believe it is reasonable to take the view that no update should be required if a company remains on track to achieve its growth targets by the end of the target period, this view may not be shared by securities regulators in Canada. As part of the comment clearing process for an IPO prospectus, a regulator may require a company to commit to providing updates of progress towards growth targets in its annual MD&A for each financial year in the target period. This would include a discussion of growth targets disclosed in the IPO prospectus, the company's actual results and a discussion of variances from the targets.

Liability for growth target disclosure

In Canada, growth targets are part of a company's prospectus disclosure, and therefore any statutory liability for misrepresentation would apply equally to growth targets as well as other information in the prospectus. Moreover, the liability safe harbour under Canadian laws that normally applies to guidance and other forward-looking information issued by public companies does not apply to forward-looking information contained in an IPO prospectus. This does not necessarily mean that a company's failure to achieve growth targets by the end of the target period would constitute a misrepresentation. This could be the case if the assumptions underlying the growth targets were found to be unreasonable. Nevertheless, companies must weigh the benefits of providing growth target disclosure against the potential risks. For a Canadian company undertaking a cross-border IPO (involving a public offering in Canada and the United States), the practice is not to include any growth target disclosure in the prospectus or roadshow materials due to liability concerns.

Growth targets are a useful supplement to a company’s growth strategy disclosure, since they help quantify the impact of growth plans from management’s perspective. Although growth targets are being more closely scrutinized by investors and more closely reviewed by securities regulators in Canada, companies looking to go public should continue to consider their benefits.