

How to Read an Earnings Report: A Beginner's Guide

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Key takeaways

- Earnings reports provide an inside look at a public company's financial performance.
- The main materials to review include the earnings press release, investor presentation, earnings call, and official filing, which includes financial statements and disclosures.
- Investors should focus on the metrics that matter most for the specific business being evaluated but also track fundamentals like revenue growth, profitability, and cash flow.
- Earnings results should be evaluated against management's guidance, Wall Street expectations, prior quarters, competitors, industry trends, and broader economic conditions.
- Headline revenue and earnings numbers rarely tell the full story, so investors should look for what drove the results before deciding what they mean for a stock.

Earnings reports offer investors a regular look under the hood of publicly traded companies. There's a lot packed into each report, from fundamental financial data like revenue and earnings to management commentary about important business decisions. Learning how to read an earnings report may help investors make more informed investment decisions by focusing on what matters most.

What is an earnings report?

An earnings report is an official document issued by a publicly traded company that details its financial performance over a specific time period. It includes information about a company's revenue, earnings, cash flow, debt, and more.

Publicly traded companies regularly file earnings reports with the Securities and Exchange Commission (SEC) before releasing them to investors. Quarterly earnings reports, called 10-Qs, and annual reports, called 10-Ks, are the most closely watched.

Investors use a company's earnings report to evaluate its profitability, financial health, and growth potential before making investment decisions. These reports also include important risk disclosures, analysis from company management, and information about things like legal proceedings and stock sales.

What is included in an earnings report?

There's a lot more to an earnings report than the headline numbers. The information each company provides in its earnings reports—and how it is presented—also varies widely, which can make analyzing earnings reports challenging for new investors. However, most quarterly reports share a few core components.

Official SEC filing

For the most complete accounting of the quarter's financial results, investors typically turn to the official SEC filing, which includes full financial statements, a statement of shareholders' equity, and other sections, such as the management's own analysis.

Three main financial statements are included in quarterly earnings reports:

- **Income statement:** This statement details a company's revenues and expenses, showing how it arrived at its profit or loss. This is where investors can find figures like EPS and net income or monitor the impact of taxes and interest income/expense.
- **Balance sheet:** The balance sheet is like a financial report card. It details a company's assets, liabilities, and the equity left over for shareholders. It's called a balance sheet because it's built on a fundamental accounting rule which says that a company's assets must equal the sum of its liabilities and shareholders' equity.
- **Cash flow statement:** This statement tracks cash entering and leaving the business during the reporting period. It's broken down into three main sections: operating activities, investing activities, and financing activities. These sections show how much cash the company's core operations generated, how much it invested into things like property and equipment, and whether it borrowed money, repaid debt, paid dividends, or repurchased shares.

In addition to the official quarterly report filed with the SEC, most companies release an earnings press release, provide an investor presentation, and hold a conference call to discuss the report with investors, analysts, and journalists.

Earnings press release

The earnings press release offers a quick snapshot of some of the most important results, such as revenue and earnings per share (EPS), along with commentary from management. Many press releases are brief, but others include detailed financial statements, forward guidance, and insights into a company's recent performance drivers.

Investor presentation

The investor presentation, sometimes called an earnings deck, pulls together the highlights of the results in an easy-to-digest format. These presentations often emphasize figures and developments that management wants to highlight. Essentially, they're curated marketing materials directed at investors.

Earnings call

Earnings conference calls provide another layer of context. Management will typically recap the latest results and then break down the company's goals and its progress toward achieving them. Details like competitive pressures and market trends are also discussed before executives take questions. Earnings calls can sometimes move a stock price dramatically, as they tend to explain why headline numbers went up or down.

How to analyze an earnings report

Analyzing an earnings report involves diving into the fundamentals, figuring out what drove the results, and putting everything in context. Seasoned investors tend to focus on metrics that can drive results or reveal risks. The metrics that matter most will depend on the business. Same-store sales are critical for a retailer, for example, while subscriber growth matters more for a streaming company.

Step 1: Start with the fundamentals

Begin by analyzing the company's financial fundamentals. Beyond the headline numbers, the figures that matter most will vary by business and industry, but there are a few metrics that typically garner attention in most earnings reports. One way to assess these figures systematically is to analyze earnings reports with a few simple questions in mind:

- Is the business growing? Look at near- and long-term revenue growth trends and compare them to competitors and the broader market.
- Is it profitable? Review gross and operating margins, net income, and EPS. Pay particular attention to whether these metrics are expanding or contracting—and watch out for one-time events that can throw off the numbers.
- Is it generating cash sustainably? Watch operating cash flow to see how much cash the core business is generating. Track free cash flow to see how much cash remains after capital expenditures to invest in growth, pay down debt, or return capital to shareholders.
- Is it on solid financial footing? Check debt and cash levels to see whether debts have become a burden for the company.
- Is it diluting shareholders? Track stock-based compensation and the total outstanding share count for signs that new share issuance could be reducing existing shareholder equity.
- How is it using its cash? Watch capital expenditures, acquisitions, debt repayments, dividends, and share repurchases to see where the company is spending its money.

Step 2: See what management expects next

Forward guidance can be just as important as quarterly or annual results. Companies typically provide forecasts for things like revenue, earnings, profit margins, capital expenditures, or other company-specific metrics over the next quarter or full year. Management may also raise, lower, or reaffirm past guidance, and those changes can sometimes overshadow the latest results.

Not every company provides official forward guidance for investors. However, earnings calls can also provide insights into management's expectations. Pay attention to what executives say about demand, costs, hiring, investment plans, competition, and other factors that could impact the business in coming quarters.

Step 3: Understand what drove the results

Headline figures are important. The media highlights revenue and EPS growth because they're critical to the long-term success of a business. However, it's also important to understand why headline figures rose or fell.

For example, a retailer can post strong EPS growth because its existing stores sold more products, and that could be a sign of strong demand. But EPS can also rise due to a share buyback program, even if

same-store sales fell. This is why it's important to understand how a company makes money and go beyond the headline figures to find out what drove the results when reading earnings reports.

Management commentary on the earnings call may help investors determine whether an improvement or setback in a headline number was driven by changes in the underlying business or a one-time event.

Step 4: Compare the results with expectations

In the short run, the market's reaction to an earnings report often depends just as much on the gap between the results and expectations as it does on the results themselves. That's why it's important to track how a company performed relative to Wall Street's forecasts each quarter.

Revenue and EPS are common places to start when comparing results with analysts' consensus estimates. However, guidance, margins, and company-specific metrics can also come in above or below forecasts. A company can beat headline estimates and still see its shares fall if investors are disappointed by the outlook or another closely watched part of the report. Conversely, results that look weak in isolation could cause a stock to rise if investors expected something worse.

Step 5: Put the earnings in context

Quarterly earnings reports rarely tell the whole story. They need to be put in context. Consider comparing the latest results with previous quarters to see whether important figures are strengthening or weakening. Then analyze direct competitors and look at broader industry trends to get a more complete picture of a company's performance.

A company seeing rapid revenue growth may still be underperforming if its competitors are claiming market share, while a firm posting weak revenue growth may be outperforming if its competitors are struggling.

The economic backdrop also matters. Weak sales during a recession may say something very different about a business than weak sales amid an economic boom. Interest rates, inflation, commodity prices, and other outside factors can also help or hurt a company. Investors can only understand how a company is doing by including all this context in their analysis.

Finally, remember to take valuations into account. Strong earnings don't automatically make a stock attractive if its price already assumes years of rapid growth. And disappointing results don't necessarily make a stock unattractive if its valuation has already fallen substantially. Fundamental results ultimately have to be considered alongside what investors are being asked to pay for them.

Bottom line: Earnings report analysis is rarely straightforward

Reading an earnings report takes more than just checking whether revenue and EPS rose or fell. Investors need to understand the business, analyze the fundamental and company-specific metrics that matter most, check actual performance versus expectations, and then consider what drove the results.

Failing to take the time to do an in-depth analysis may lead investors to the wrong conclusions after reading an earnings report. The only way to make more informed investment decisions is to have the whole picture in mind, not just a snapshot of headline trends.

What are the most important metrics to watch in an earnings report?

The most important metrics to watch depend on the company, its industry, an investor's goals, and other factors. However, many investors focus on metrics like revenue, EPS, net income, operating margins, and free cash flow.

What are GAAP earnings?

Generally Accepted Accounting Principles, or GAAP, are a strict set of accounting rules, standards, and procedures set by the Financial Accounting Standards Board (FASB). GAAP earnings follow these rules, allowing investors to compare companies on a level playing field.

Why do some companies report non-GAAP earnings?

All domestic companies that trade on U.S. exchanges must follow GAAP when filing financial statements with the SEC. However, foreign companies that trade on U.S. exchanges are allowed to use International Financial Reporting Standards (IFRS) instead.

What are "adjusted" earnings?

Sometimes companies will adjust earnings metrics like EPS to remove the impact of one-time events that may not reflect their true performance. However, adjusted earnings can also be misused if companies exclude regular expenses, such as recurring stock-based compensation, to make their earnings look better.

Where can I find official earnings reports?

Official earnings reports can be found using the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system or the investor relations page on a company's website.

How do I find out when a company will report earnings?

Companies typically announce when they will report earnings in a press release and then post that information on their investor relations pages. However, many investors use earnings calendars to find out when a company will report earnings. Earnings calendars can be found on the websites of many stock exchanges and media outlets like Nasdaq® or YahooFinance. Schwab clients can access Schwab's earnings calendar under the Research tab by selecting Calendar > Earnings.

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Source: <https://www.schwab.com/learn/story/how-to-read-an-earnings-report>