An Investigation of Firms’ Propensities to Meet or Miss Analysts’ Forecasts of Cash Flows and Earnings

While a large stream of literature examines firms’ propensities to meet or beat analysts’ earnings forecasts, similar research regarding analysts’ cash flow forecasts has received little attention in spite of cash flows’ importance as a performance measure. We investigate firms’ propensities to meet or miss analysts’ cash flow and earnings forecasts in the same fiscal quarter. We document that firms are most (least) likely to meet (miss) both forecasts, and second (third) most likely to meet earnings (cash flow) forecasts but miss cash flow (earnings) forecasts. Our findings indicate that this rank ordering of firms’ propensities to meet or miss cash flow and earnings forecasts mirrors the rank ordering of the stock price reaction observed for the four meet-or-miss categories. We investigate factors explaining why firms sometimes meet cash flow forecasts but miss earnings forecasts. Our results show that firms are more likely to be in this category when: (1) adverse valuation consequences of missing earnings forecasts but meeting cash flow forecasts are relatively less severe; (2) analyst following of cash flows vis-à-vis earnings is relatively large; (3) firms are in financial distress; (4) analysts forecast extreme positive accruals; (5) analysts walk down their cash flow forecasts but not their earnings forecasts; (6) firms have bloated balance sheets; and (7) firms report decreases in earnings but not cash flows. Our investigation provides insight into firms’ propensities to meet or miss forecasts of different performance measures, and furthers our understanding of why firms sometimes meet certain forecasts but miss others.