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Client Alert

Latham & Watkins
Capital Markets Practice Group

Recent Developments In Recent Developments — Using "Flash" Numbers in Securities Offerings

"This *Client Alert* will explore market practice, SEC Staff approach, case law, Regulation FD and comfort issues associated with disclosure of recent results in offering documents."

Here are the three scenarios we address in this *Client Alert*: Corbet's Coolers Inc., a Wyoming corporation, wants to sell securities on June 1, July 31 or August 10. Let's assume that Corbet's reports on a calendar year basis and is an SEC registrant that has timely filed all of its periodic reports. In each case, Corbet's and its underwriters will ask, "What can (or should) we say about the second quarter on the road show?" The answer, of course, depends on all of the facts and circumstances. This *Client Alert* will explore market practice, SEC Staff approach, case law, Regulation FD and comfort issues associated with disclosure of recent results and examine how and why the answer may differ at each of these three dates.

Why Not Just Say Nothing?

Saying nothing can be a real option, particularly for a large seasoned issuer, if the issuer expects that the results for the most recent quarter will merely continue current trend lines ("more of the same") and if the issuer otherwise has little risk of unpleasantly surprising the market when actual results are announced. However, Corbet's might decide to tell investors about its estimated results for the second quarter if it expects them to be unusually weak or unusually strong.

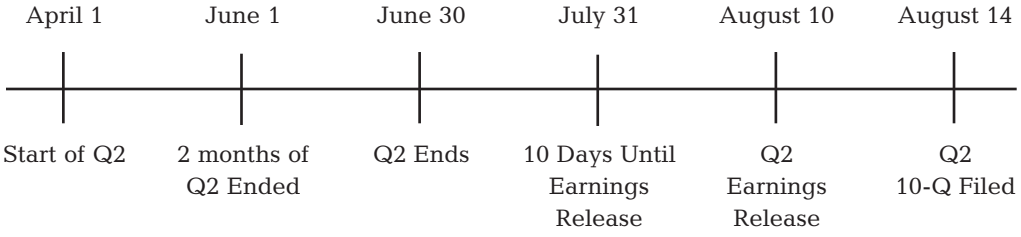
If Corbet's most recent results suggest a downtick in the business, Corbet's may want to consider disclosure about those results to avoid a claimed material omission that could potentially trigger liability under the federal securities laws. Issuers using incorporation by reference must disclose "all material changes in the registrant's affairs" since the end of the last fiscal year that have not been disclosed in a subsequent Exchange Act filing.[1] Item 303 of Regulation S-K requires disclosure of "known trends or uncertainties" that the registrant reasonably believes have had or will have a material impact on operating results. Rule 408 under the Securities Act requires all registration statements to include all material information necessary to make the statements contained therein, in light of the circumstances under which they are made, not misleading.

Despite some favorable case law, which we will discuss below in some detail, Corbet's underwriters will not wish to unpleasantly surprise their buy-side customers with a disappointing quarterly report right after the offering closes. For the same reason, Corbet's own lawyers will not want their client selling securities without properly foreshadowing the bad news to come.

On the other hand, if the most recent results will show a significant improvement in performance (or even stable performance in the face of troubles in Corbet's industry), Corbet's underwriters may want to share those results with investors in order to satisfy investor questions and facilitate marketing of the offering. This motivation may be particularly strong in the case of initial public offerings, for issuers with more limited operating histories or in offerings being conducted in the issuer's first fiscal quarter, where the last audited financial statements may be up to 15 months old.[2]

What Do Most People Do?

In answering the question "What do most people do?," we must first ask where the pricing of the offering will fall in the reporting cycle. At the risk of oversimplifying, we have included the following timeline to facilitate a discussion of the issues:



We will focus on three possible pricing dates:

- June 1 (quarter in progress)
- July 31 (quarter complete, no earnings release)
- August 10 (earnings release, no 10-Q)

The issues are slightly different at each of these pricing dates, so we will analyze each date separately.[3]

Quarter in Progress. For an offering scheduled to price on June 1, "say nothing" is the most likely solution. Absent fairly compelling evidence that results for the quarter in progress are either (1) deteriorating rapidly or (2) heading through the roof, it would be unusual to include abbreviated financial results, or "flash numbers," or even a qualitative description of results, for a partially completed quarter. If the working group feels compelled to say anything at all about a quarter in progress, it would be more common to project how the full quarter might turn out.

Such a projection is commonly referred to as "guidance" and should be a "forward-looking statement" for purposes of the safe harbor afforded by the Private Securities Litigation Reform Act of 1995.[4] As such, it would enjoy a greater degree of protection than a statement of historical fact if (among other things) it is accompanied by meaningful cautionary statements. However, many companies prefer not to provide guidance at all, or provide guidance for the full fiscal year only and not on a quarter-by-quarter basis. The case law generally supports a view that there is no duty to disclose results for a quarter in progress absent highly unusual circumstances.

Recently Completed Quarter. If pricing is planned for July 31, the market will be curious about how the second quarter turned out. The period between the end of a fiscal quarter and the publication of the earnings release for that quarter is when flash numbers are most commonly used. The need for some disclosure relating to results for the recently completed quarter depends both on the extent of the expected deviation from previously disclosed results (or guidance) and the availability of reliable data.

The pressure to make some disclosure increases during this period as Corbet's works to close its books and the earnings release date draws closer. Corbet's may decide simply to postpone the pricing of its offering until earnings are released in order to avoid the risk of liability associated with a claimed failure to disclose. Alternatively, Corbet's may decide to forge ahead and add disclosure as necessary.

Where the decision is made to say something about a recently completed quarter, market practice is to include flash numbers under a heading such as "Recent Developments" or "Recent Results" in the summary box of the prospectus. The flash numbers typically include revenue figures for the most recently completed quarter and may include other financial data (such as gross margin, EBITDA, operating income or even net income), depending upon the availability of reliable cost data. Although less common, end-of-period balance sheet items may also be included, if material.[5]

Because flash numbers are often merely preliminary estimates, and because the final reported results may diverge from these estimates,[6] Corbet's may decide to present its flash numbers as ranges rather than as specific numbers. Flash numbers are often accompanied by a comparison to the corresponding financial results for the same period in the prior fiscal year, as well as a discussion, however brief, of the reasons for the expected period-to-period changes.

After Earnings Release and Before the 10-Q. An August 10th pricing date is somewhat problematic. Pricing an offering after the earnings release but only days before the filing of the related Form 10-Q is less than ideal. A Form 10-Q filing is much more information-rich than even the most robust earnings release. The MD&A alone typically includes a number of important nuggets of information that are not in the earnings release. As a result, on these facts, Corbet's probably will elect to wait for four days until the Form 10-Q is filed before pricing its offering.

However, we have seen issuers price deals based on an earnings release where the related Form 10-Q filing is more than a few days away. These are typically seasoned issuers with a strong track record for accuracy in their earnings releases, where the working group is able to conclude that the added detail in the coming Form 10-Q filing will not affect the trading price of the securities being offered. That conclusion is easier to reach in an offering of investment-grade debt securities, of course, than in a common stock offering.

How Does the SEC Staff Feel About All This?

A number of recent SEC Staff comments on filings have called on issuers to explain supplementally[7] to the Staff why it is necessary to provide a range, rather than a specific number, for financial results *for a recently completed fiscal period*. We are aware of some cases in late 2010 in which the Staff raised concerns about the use of ranges, as opposed to specific numbers, for flash results, where several weeks had elapsed since the end of the applicable quarter. Some wondered if the Staff was moving categorically to oppose the use of ranges in flash numbers for completed reporting periods.

However, in a speech given in January 2011, Shelley Parratt, Deputy Director for Disclosure Operations of the SEC's Division of Corporation Finance, affirmed that the Staff will continue to allow the use of ranges after the end of a fiscal period if the range represents a narrow, meaningful estimate in light of the circumstances, and is accompanied by appropriate disclosures.[8]

Similarly, in a meeting of SEC Staff with the Center for Audit Quality SEC Regulations Committee in late

March 2011, Mark Kronforst, Associate Director in the Division of Corporation Finance, stated that a registration statement may include preliminary financial information for a completed period, but that the information must be presented in a balanced manner. For example, Kronforst explained, if revenue increased but net income decreased, it would not be appropriate to disclose only a revenue estimate.[9]

Consistent with these SEC Staff comments, we have noted in recent months that issuers can expect Staff tolerance for the use of ranges where issuers have not had time to complete their financial closing procedures for the most recent fiscal period. The Staff comment process, described further below, may result in a narrowing of the disclosed range, and the pressure to narrow the range may be greater where a longer interval has elapsed since quarter-end immediately preceding the filing of the registration statement or amendment that contains the ranges.

What SEC Staff Comments Should Corbet's Expect and How Should It Respond?

If Corbet's decides to take the leap and include flash number ranges in its prospectus, Corbet's should prepare for possible SEC Staff comments as follows, and indeed should attempt to preempt comments by including appropriate disclosures along with the flash number ranges in the filed prospectus.

Supplemental Information. First, the SEC Staff may ask Corbet's to provide supplemental information to the Staff regarding (1) how the ranges were determined, (2) what management assumptions underlie the financial estimates provided and whether there are any key factors on which results depend and (3) why it is necessary to provide a range rather than a specific number.

Corbet's response to comment (1) would likely consist of a detailed explanation of the issuer's processes for determining each of the relevant ranges, including, for example, its internal forecasting process, its completed monthly closing procedures, and additional processes for estimating results for uncompleted monthly closings.

Corbet's response to comment (2) would likely focus, among other things, on the degree of historical variance between early estimates of results and the final reported results, and would show that both the high and low end of the disclosed range are reasonably obtainable in light of the historical variance pattern.

Corbet's response should further detail the key components and assumptions underlying the disclosed results, for example the various cost components and related assumptions. The response should explain which of those components reasonably have been calculated as point estimates, which of those components have been estimated as ranges based on then available information, and why a range calculation has been used in respect of each component in the latter category.

Corbet's response to comment (3) would likely discuss the current state of its financial closing procedures, and tie together the responses in (1) and (2) above to explain why the disclosed ranges are both reasonably estimable and necessary.

Disclosure. Second, the SEC Staff may request that Corbet's flash number ranges be accompanied by enhanced disclosures relating both to the substance of the estimated financial results and the process of estimating those results.

Substantively, the SEC Staff may request disclosure to address, both quantitatively and qualitatively, the forces underlying any significant changes from prior period financial results. Thus, Corbet's would need to include a "mini-MD&A," which may be nothing more than a few sentences, explaining the changes. The

use of an abbreviated MD&A can be helpful in reaching the conclusion that the added information in the upcoming Form 10-Q is not material, but simply a more granular version of the headlines contained in the mini-MD&A.

With regard to procedure, the SEC Staff may ask Corbet's to provide investors with a meaningful framework for analysis of the estimated results. In this connection, the Staff may ask Corbet's to consider including disclosure along the lines of the supplemental information provided to the Staff (as discussed above). A meaningful disclosure framework might consist of an explanation (1) that financial closing procedures for the period in question are incomplete, (2) that final results may vary from any preliminary estimates, (3) of factors that may cause such variations, (4) of the components of financial results as to which specific amounts cannot yet be determined, (5) of how the estimates for these components have been derived and (6) of the expected timing for completion of financial closing procedures. We have included a template at the end of this *Client Alert* that might be useful as a starting point for a "Recent Results" section for your offering.

We note that the SEC Staff has, in some recent comments, asked some issuers to include not just revenues in its flash numbers, but also a total expense or net income figure. This can be problematic when the issuers' estimating procedures around costs are not as sharp as those around revenues. In such cases, it may be possible to justify use of a wider range for costs or income figures than that used for revenue estimates. We also note that any non-GAAP metrics included within flash numbers that are historical will be subject to the same restrictions and requirements that accompany the use of final non-GAAP financial results under Item 10(e) of Regulation S-K and Regulation G. However, if non-GAAP financial results can be characterized as forward-looking, then quantitative reconciliation with GAAP measures will only be required where possible without "unreasonable effort." Where reconciliation is not possible without unreasonable effort, an issuer must disclose that fact.

What About Regulation FD?

Regulation FD's prohibition of selective disclosure contains an exception for oral communications made in respect of registered offerings, after the registration statement has been filed.[10] Does this mean that Corbet's can omit the flash numbers from its prospectus but talk about them on the road, and thereby avoid SEC Staff review?

Our typical answer is no. Rule 10b-5 generally prohibits the disclosure of material non-public information to persons who might trade on the information ("tipping"), regardless of whether Regulation FD is applicable. Disclosing material information about the issuer on a roadshow, accordingly, risks running afoul of Rule 10b-5 unless the information is contained in, or derivable from, the prospectus (or other prior public disclosures by the issuer). Even though Regulation FD includes an exception for issuer statements at the roadshow meetings, we generally do not recommend relying on that exception, if possible.

In contrast, disclosure of flash numbers in the roadshow presentation is appropriate (and indeed expected) if Corbet's has made the decision to include flash numbers in the preliminary prospectus. The degree to which Corbet's can venture into a detailed discussion of flash results in the roadshow will be a direct function of the extent of information included in the prospectus. As a result, inclusion of a "mini-MD&A" with respect to the most recent quarterly results in the prospectus will facilitate a more meaningful roadshow discussion of current trends.

We should note that even though the

prospectus is a publicly filed document, Corbet's should take the added step (as would most issuers) of "pre-releasing" its estimated quarterly results by means of a press release filed as an exhibit to a Current Report on Form 8-K. Obviously, the issuer will not have performed all of the procedures it normally would have performed prior to issuing its actual earnings information; the purpose of the pre-release is to inform the market generally of flash results concurrently with the commencement of the marketing process. Similarly, if the issuer elects to give guidance at the road show meetings, it should make the same guidance public through a press release and a Form 8-K filing.[11]

Note that Regulation FD applies to disclosures in private offerings by reporting companies without any roadshow exception. The disclosure in a private offering memorandum of flash numbers, or guidance about expected results for a quarter in progress, would be viewed as selective disclosure of material non-public information in violation of Regulation FD, unless the recipients of the offering memorandum agree to keep its contents confidential (which is not typical market practice). The solution to this conundrum is to file a Current Report on Form 8-K that includes the flash numbers or the guidance (and any other material non-public information contained in the offering memorandum) on the day the offering memorandum is mailed. This approach, which has been standard operating procedure for many years, was recently recognized by the SEC Staff in its Compliance and Disclosure Interpretations.[12]

Will Accountants Provide Comfort on Flash Numbers?

Counsel for Corbet's underwriters will want to have a discussion with Corbet's accountants about whether the accountants' comfort letter will cover the flash numbers. The availability of accountants' comfort, and the level of such comfort, will depend on the facts. If the flash numbers are actually guidance regarding a quarter still in progress, or if the flash numbers are ranges, comfort will not be available. If, however, the flash numbers are taken from the general ledger, agreed-upon procedure (or "tick-mark") comfort may be available. Revenue numbers may be available in the general ledger shortly after the quarter ends. Expense numbers are typically not available until much later in the quarter-closing process.

In situations where the accountants are unable to provide "tick-mark" comfort on flash numbers, counsel to Corbet's underwriters will want to design an appropriate due diligence procedure that will enable them to develop confidence in the flash numbers. That procedure likely will include detailed discussions directly with Corbet's finance staff regarding how the flash numbers were derived, a review of available monthly financial data for April, May and June (if available) and a review of the historical accuracy of Corbet's earnings releases as compared to its subsequently filed financial statements.

The underwriters' counsel will also likely take a hard look at the "negative assurance" paragraphs in the accountants' comfort letter, and the existence (or absence) of any references therein to declines in key operating results since the most recently filed financial statements. Each situation calls for a due diligence drill specifically tailored to the facts of that situation. There is no one-size-fits-all procedure to follow here.

What Do the Courts Say?

In general, assuming that an issuer's included financial statements are recent enough to comply with Rule 3-12 of Regulation S-X, issuers risk liability for failing to disclose pending or not-yet-released quarterly results only if, at

the time that the registration statement becomes effective, the issuer is in possession of information indicating that actual quarterly results will be an "extreme departure" from the range of results that could be anticipated from existing disclosure.

The "extreme departure" standard is a stringent one, and courts tend to find that an issuer had a duty to disclose preliminary quarterly results only in extraordinary situations. However, if an issuer is aware of facts that have occurred since the last public reporting of results that can reasonably be expected to negatively and materially impact earnings beyond the current quarter, those facts may nevertheless have to be disclosed as a "known trend or uncertainty" under Item 303 of Regulation S-K or to make the statements actually made in the prospectus "not misleading," as required by Rule 408.

Shaw and the "Extreme Departure" Standard

Shaw v. Digital Equipment Corp. (1996),[13] which established the "extreme departure" standard, addressed a situation where a prospectus pursuant to an S-3 shelf registration statement was filed 11 days prior to the end of the quarter in progress without inclusion of intra-quarterly information that would have disclosed an unexpected $183 million quarterly operating loss, in contrast to the $72 million operating loss reported for the previous quarter.

The US Court of Appeals for the First Circuit overturned the district court's dismissal of a securities class action, holding that plaintiffs had stated a claim under Section 11 of the Securities Act:

> If, as plaintiffs allege here, the issuer is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information, it is consistent with the basic statutory policies favoring disclosure to require inclusion of that information in the registration statement.

Later that year, the First Circuit clarified *Shaw* in *Glassman v. Computervision Corp.*[14] In *Glassman*, the issuer disclosed six weeks after its IPO that its third quarter revenue and operating results would be lower than expected. In an opinion written by the same judge who wrote the *Shaw* opinion, the court stated that "there is a strong affirmative duty of disclosure in the context of a public offering . . . [and] the same may be even more emphatically true in an initial public offering, where the securities have not before been publicly traded."

Still, the court found that the facts in *Glassman* did not rise to the level of those in *Shaw*:

> [W]hen the allegedly undisclosed information (here only seven weeks into the quarter – and where mid-quarter results were not particularly predictive) is more remote in time and causation from the ultimate events of which it supposedly forewarns, a nondisclosure claim becomes "indistinguishable from a claim that the issuer should have divulged its internal predictions about what would come of the undisclosed information."

Application of the "Extreme Departure" Standard to Offerings Concluding After Quarter-End but Before the Earnings Release

With *In re N2K Inc. Securities Litigation* (1999),[15] the District Court for the Southern District of New York applied the "extreme departure" standard articulated in *Shaw* in the context of an equity offering. The offering was completed roughly six weeks after the conclusion of N2K's first quarter, but about a week before the company released its first quarter financial results. The actual results revealed higher-than-

expected losses, causing the price of N2K shares to decrease by a third over the course of a day. The court asked whether the magnitude of the surprise alleged by plaintiffs rose to the level of an "extreme departure" and found that it did not. Relying on the fact that the financial statements included in the prospectus demonstrated a trend of losses, and that the prospectus incorporated an exhaustive set of relevant risk factors, the court granted the defendants' motion to dismiss, holding that "defendants' actual losses for the interim period in question were not beyond the range of plausible results based on available information at the time of the offering."

In 2010, in another decision from the Southern District of New York, *In re Focus Media Holding Limited Litigation*,[16] the court again applied the "extreme departure" test and dismissed the complaint. *Focus Media* involved a secondary offering on a registration statement that was filed and became effective after the end of the company's third quarter but before third-quarter results were formally released.

About five weeks prior to filing its registration statement, Focus Media had issued a press release, which included guidance regarding anticipated third quarter results, including forecasts of the company's gross margins. The actual gross margins turned out to be lower than expected. The plaintiffs alleged that Focus Media's registration statement failed to meet disclosure requirements because it did not include information about the company's third-quarter financial performance and the disappointing gross margins.

In dismissing the complaint, the court found that Focus Media's omission of its third quarter results was not material. Distinguishing the situation from the facts of *Shaw*, the court pointed out that, while Focus Media's gross margins were lower than forecast, its total revenues and income were higher. The court found that, when considered as a whole, the quarterly gross margin decline could not be characterized as an "extreme departure" from the range of anticipated results.

Litwin and Item 303 of Regulation S-K

The *Shaw* "extreme departure" standard applies when an issuer becomes aware of concrete developments in an ongoing quarter that has impacted (or will negatively impact) the financial results for the quarter in progress. A separate inquiry is required when an issuer learns of significant events or circumstances that will have a substantial impact on the operating results or financial condition of the company in the future, even if the impact on the quarter in progress may not be material.

Item 303 of Regulation S-K requires issuers to disclose "known trends and uncertainties" that are reasonably likely to affect financial results. The Item 303 inquiry requires a two-pronged analysis: (1) when is a trend or uncertainty "known," and (2) when is a known event, trend or uncertainty sufficiently material to warrant disclosure. Also, Securities Act Rule 408 requires disclosure of additional facts whenever disclosure is necessary to make the statements actually made elsewhere in the prospectus not misleading.

Issuers should be aware that determining whether a trend or uncertainty is "known" for the purposes of Item 303 of Regulation S-K is a fact-specific and unpredictable endeavor that depends heavily on the timing of a prospectus. For example, in *In re DreamWorks SKG, Inc. Animation Securities Litigation* (2006),[17] industry-wide dynamics in the DVD market were reflected in unexpected numbers of customer returns of "Shrek 2" DVDs, which resulted in significantly lower revenues than the market anticipated. The court held that, at the time the DreamWorks prospectus

became effective, no one understood this dynamic well enough for it to be considered a "trend," and granted the defendants' motion to dismiss.

The court reached a similar conclusion in *In re Noah Educational Holdings, Ltd. Securities Litigation* (2010),[18] an unpublished decision. There, the District Court for the Southern District of New York held that an undisclosed two-month "spike" in the cost of raw materials could not reasonably be considered a trend, and that a lengthy risk factor section including a description of risks stemming from raw material costs was sufficient to satisfy the issuer's duty to make the statements made elsewhere in the prospectus not misleading, as required under Rule 408.

In contrast, with *In re The Children's Place Securities Litigation* (1998),[19] the District Court of New Jersey found, in another unpublished decision, that plaintiffs had alleged facts sufficient to state a claim that Children's Place's disappointing back-to-school season results were sufficiently known to the issuer at the time of its IPO to require disclosure as a known trend under Item 303 of Regulation S-K. Particularly in the context of statements in the prospectus that the back-to-school season typically generated a substantial percentage of yearly sales, the court refused to dismiss the plaintiff's claim that the failure to disclose the disappointing sales was misleading.

Even if a trend or uncertainty is unquestionably known at the time a registration statement becomes effective, to prevail against a defendant's motion to dismiss, a plaintiff must plead that the defendant's omission was also material. In a 2011 decision, *Litwin v. The Blackstone Group, L.P.*,[20] the US Court of Appeals for the Second Circuit overturned the District Court's dismissal of a putative class action, in which plaintiffs alleged that Blackstone had violated Section 11 of the Securities Act by failing to disclose known uncertainties as required by Item 303 of Reg S-K.

The *Litwin* plaintiffs claimed that, at the time it concluded its IPO, Blackstone knew of the occurrence of several adverse events that would negatively affect several of Blackstone's portfolio companies and thereby require Blackstone to return fees it had already been paid. The possibility of a future "claw-back" was not an issue for the quarter in progress at the time of the IPO, but was a known uncertainty (plaintiffs claimed) that was foreseeably likely to have a material impact on future earnings.

In analyzing the Item 303 claim, the court applied the materiality standard articulated in Staff Accounting Bulletin No. 99, and examined quantitative and qualitative factors bearing on the materiality of Blackstone's omissions. The court denied the defendants' motion to dismiss, concluding that events such as the loss of one portfolio company's largest customer contract, or downward trends in the real estate market that could reasonably be expected to negatively impact Blackstone's real estate investment segment at some point in the future, may be sufficiently material to warrant disclosure under Item 303 of Regulation S-K. The Court of Appeals vacated the District Court's judgment granting the motion to dismiss and remanded for further proceedings.

Because the uncertainties cited in Litwin were not expected to impact the results of the quarter in progress, the court did not apply the "extreme departure" standard articulated in *Shaw*. The Item 303 analysis was a highly fact-specific inquiry into who knew what when and whether those facts were material and, as such, the plaintiffs were able to survive Blackstone's motion to dismiss.

Lessons From the Case Law

The case law provides issuers with a number of valuable lessons. First, timing and causation matter. As we

learn from *Shaw* and *Glassman*, the more information an issuer has about a particular quarter, the closer completion of an offering is to quarter-end and the more predictive the undisclosed information appears to be, the easier it will be for a plaintiff to survive a defendant's motion to dismiss.

Second, if an issuer has doubts about whether or not it is required to disclose end-of-quarter or quarter-in-progress information, disclosing forward-looking statements may decrease the likelihood of a plaintiff's success at the motion to dismiss stage. As the court pointed out in a footnote in *Shaw*, if the issuer had simply disclosed some guidance regarding quarterly results, rather than remaining silent, "such a disclosure (if reasonable) could very well have rendered the 'hard' interim information underlying the projection immaterial as a matter of fact or law…" Moreover, an issuer providing such guidance will be able to rely on the PSLRA's "safe harbor" for forward looking statements.

Third, when evaluating the materiality of undisclosed quarterly results, courts look at a prospectus as a whole, so even if disclosing guidance or projections is impossible or undesirable, a robust, thoughtful and current disclosure of risk factors can offer protection against claims based on Item 303 of Regulation S-K or Rule 408.

Finally, for issuers considering whether or not to disclose not-yet-released quarterly results in a registration statement, *Shaw* is not the end of the analysis. Item 303 of regulation S-K and Rule 408 call for a further inquiry. As the Second Circuit made clear in *Litwin*, Item 303 requires issuers to look beyond the end of the quarter in progress and ask whether known trends or uncertainties could be material in the future. If an event has occurred that only minimally impacts results for the current quarter but could significantly impact the company's results of operations or financial condition down the line, a separate inquiry is required to determine whether that event, trend or uncertainty ought to be disclosed.

Although the legal standard regarding disclosure of quarterly results is generally favorable to issuers, actual market practice is cautious, as it should be, particularly after *Litwin*. As discussed earlier, underwriters generally prefer to manage investor expectations for even modest departures from anticipated results. And even in situations where investors expect an adverse result, the safe and customary practice is to make appropriate disclosures that foreshadow the coming bad news. If you are an issuer, you want to win your motion to dismiss.

Conclusion

Flash numbers that include properly constructed and explained ranges will generally pass muster with the SEC Staff. However, the tightness of the range (or in some cases, the use of any range at all) will be correlated in significant part to the amount of time elapsed since the end of the completed period. Issuers who wish to report flash numbers using ranges may be called upon to demonstrate that their financial closing procedures remain incomplete and that their revenue and income results are nevertheless reasonably estimable within an appropriate range. Further, issuers must be willing to provide disclosure to investors responsive to Staff concerns.

The answer to the question "What do most people do?" depends on the facts and circumstances. In some cases, the better answer is to wait for the filing of the Form 10-Q before pricing your offering. Where time pressures discourage delay, pre-releasing earnings may be the only good option. In any case, careful thought about what previously has been disclosed and what the market expects should be part of the analysis.

Endnotes

[1] Item 11(a) of Form S-3; *see also* Item 11A of Form S-1 (containing a similar requirement where the registration statement incorporates information by reference from Exchange Act filings).

[2] *See* Rule 3-01 of Regulation S-X.

[3] Although our Corbet's example involves a reporting issuer, flash numbers are also commonly used in initial public offerings before full financial results are available for the most recent fiscal quarter, as well as in offering documents for unregistered offerings under Rule 144A. The issues discussed in this *Client Alert* are accordingly relevant to IPOs and Rule 144A offerings.

[4] *See* Section 27A of the Securities Act.

[5] Available cash or total debt balances, to take two examples, may be of interest to investors in some companies.

[6] Flash numbers are reported only when full financial results for the latest period have not yet been reviewed (in the case of quarterly information) or audited (in the case of annual results). Even if the latest financial statements included in the filing are not yet stale, the filing must include audited financial statements for the most recently completed fiscal year if they "are available or become available prior to the effective date of the registration statement or the mailing date of a proxy statement." *Financial Reporting Manual*, SEC Division of Corporation Finance at 27 (noting that availability is "determined on a facts and circumstances basis"). An issuer should similarly consider whether quarterly financials should be included or incorporated in the filing, or filed by amendment, if available prior to effectiveness of the registration statement.

[7] The practice of providing information to the SEC Staff for the Staff's benefit in its review process is referred to as "supplemental" to distinguish it from the disclosure of information to investors in the filed registration statement. *See* Rule 418.

[8] S. Parratt, Remarks in Panel Discussion of "Capital Transactions in 2011," Securities Regulation Institute, San Diego, California (Jan. 20, 2011).

[9] Center for Audit Quality SEC Regulations Committee, Minutes of Joint Meeting with SEC Staff (Mar. 29, 2011).

[10] Regulation FD, Rule 100(b)(2)(iii)(F).

[11] *See* Rule 101(e) of Regulation FD. Please note that, in addition to a filing on Form 8-K, most issuers choose also to issue a press release.

[12] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Sections, Question 139.32 (Mar. 4, 2011), available at http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm. Note that the entire offering memorandum should not be filed, because that would be inconsistent with the use of a private placement exemption.

[13] 82 F.3d 1194 (1st Cir. 1996).

[14] 90 F.3d 617 (1st Cir. 1996).

[15] 82 F. Supp. 2d 204 (S.D.N.Y. 1999).

[16] 2010 U.S. Dist. LEXIS 32370 (S.D.N.Y., Mar. 30, 2010).

[17] 2006 U.S. Dist. LEXIS 24456 (C.D. Cal., Apr. 12, 2006).

[18] 2010 U.S. Dist. LEXIS 34459 (S.D.N.Y., Mar. 31, 2010). Please note that Latham & Watkins LLP represented Noah Educational Holdings in its IPO and in its successful motion to dismiss.

[19] 1998 U.S. Dist. LEXIS 22868 (D.N.J., Sept. 4, 1998).

[20] 634 F.3d 706 (2d Cir. 2011).

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**Admitted to practice only in Maryland; all work supervised by a member of the DC Bar.*

Appendix: Sample Disclosure Template

This template is designed for disclosure of flash numbers after the close of a fiscal quarter but prior to the filing of the Quarterly Report on Form 10-Q for that quarter. It is intended to foster an open dialogue and not to establish firm policies or best practices. Depending on your specific situation, answers other than those oulined below may be appropriate.

Recent Results

We have not yet closed our books for our second fiscal quarter ended June 30, 2011. Our independent registered public accounting firm has not completed its review of our results for our second quarter. Set forth below are certain preliminary estimates of the results of operations that we expect to report for our second quarter. Our actual results may differ materially from these estimates due to the completion of our financial closing procedures, final adjustments and other developments that may arise between now and the time the financial results for our second quarter are finalized.

The following are preliminary estimates for our quarter ended June 30, 2011:

GAAP

- Revenue is expected to be between $___ million and $____ million, an increase of __% at the midpoint of the range as compared to $___ million for the quarter ended June 30, 2010. The estimated increase in revenue is primarily due to [narrative discussion].
- [Income (loss) from operations is expected to be between $___ million and $___ million as compared to $___ million for the quarter ended June 30, 2010. The estimated improvement in income (loss) from operations compared to the corresponding period in 2010 is primarily due to [*narrative discussion*].]*
- [Net income (loss) is expected to be between $___ million and $___ million as compared to net loss of $___ million for the quarter ended June 30, 2010. The estimated improvement in the net income (loss) compared to the corresponding period in 2010 is primarily due to [*narrative discussion*].]*

Non-GAAP

- Adjusted EBITDA is expected to be between $___ million and $___ million, an increase of __% at the midpoint of the range, as compared to $___ million for the quarter ended June 30, 2010. Our Adjusted EBITDA estimate for the quarter ended June 30, 2011 reflects our estimated net income (loss) of between $___ million and $___ million, plus estimated interest expense of $___ million, estimated income tax provision of $___, estimated depreciation of $___ million, and estimated amortization of $___ million. In estimating Adjusted EBITDA for our second quarter, we have assumed there will be no unusual or extraordinary losses, charges or expenses during the period. Our Adjusted EBITDA for the quarter ended June 30, 2010 reflects our net income (loss) of $___ million plus interest expense of $___ million, income tax provision of $___, depreciation of $___ million and amortization of $___ million, further adjusted to exclude the impact of … [*explain other adjustments*]. The estimated increase in Adjusted EBITDA is primarily due to [*narrative discussion*].

We include Adjusted EBITDA in this prospectus for the reasons as described in "Summary Consolidated Financial Information and Other Data – Non-GAAP Financial Measures." Adjusted EBITDA has certain limitations in that it does not reflect all expense items that affect our results. These and other limitations are described in "Summary

Consolidated Financial Information and Other Data – Non-GAAP Financial Measures." We encourage you to review our financial information in its entirety and not rely on a single financial measure.

We have provided a range for the preliminary results described above primarily because our financial closing procedures for the month and quarter ended June 30, 2011 are not yet complete. As a result, there is a possibility that our final results will vary from these preliminary estimates. We currently expect that our final results will be within the ranges described above. It is possible, however, that our final results will not be within the ranges we currently estimate. Among the components of our operating results that are subject to change as a result of our year-end closing procedures are: [*narrative discussion of line item estimates and how they were derived.*] We expect to complete our closing procedures for the quarter ended June 30, 2011 in August 2011.

* *It may be appropriate to omit estimates of operating income and net income where expense data are not yet available in sufficiently reliable form.*
