

Biases in Analysts' Long-Horizon Forecasted Income Statements, Balance Sheets, and Cash Flow Statements

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ABSTRACT

We study US sell-side equity analysts' granular multiyear forecasted income statements, balance sheets, and cash flow statements and the profitability, efficiency, and leverage ratios they imply. Using data from analyst reports over a twenty-year period, we find numerous biases in analysts' long-horizon forecasted financial statements. Most, but not all, of these biases are optimistic. Analysts optimistically forecast long-horizon EPS, ROE, ROA, ROS, and asset turnover, driven by optimistic projections of revenues and most common-sized expenses. However, book income tax is consistently forecasted pessimistically. Analysts are also optimistic about long-horizon operating cash flows and operating accruals. While their forecasts of long-horizon total assets are unbiased, they optimistically underestimate firm risk by either underestimating long-horizon debt or overestimating long-horizon equity. This translates into analysts underestimating the long-horizon non-operating return component of ROE. Lastly, we find analysts' long-horizon optimism of revenue, expenses, and income are associated with optimism in their target prices.

Keywords: Analysts; biases; financial statement analysis and valuation; long-horizon forecasted financial statements, optimism, normative recommendations

JEL Classifications: G17, M41

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