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# Earnings Management and The Post-Issue Underperformance in Seasoned Equity Offerings

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## Abstract

Ritter and Loughran~(1995a) and Spiess and Affleck-Graves~ (1995) document that firms issuing seasoned equity offerings (SEOs) severely underperform the stock market within five years after the offering. Our paper examines the hypothesis that SEO investors are too optimistic because they naively extrapolate earnings trends without fully adjusting for observable discretionary managerial reporting choices. We find that aggressive firms, which report high pre-SEO earnings at the expense of post-SEO earnings by taking high pre-issue discretionary current accruals, subsequently perform worse in terms of abnormal stock returns and industry-adjusted net income. Aggressive quartile firms earn a highly significant --48% four-year compounded abnormal return; conservative quartile firms earn an insignificant --7% four-year compounded abnormal return. In contrast with the pre-SEO discretionary current accruals, the non- discretionary current accruals and both discretionary and non- discretionary long-term accruals do not predict post-SEO returns reliably.

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