

Non-GAAP Measures

What Are They and Why Are They Presented?

September 22, 2021
6:45 – 8:00


Betsy Wills
Director and VP Education, Rocky Mountain Chapter

www.rmchapter.org

www.betterinvesting.org

1

1




What is GAAP?

- GAAP = Generally Accepted Accounting Principles
- Established accounting principles issued by the Financial Accounting Standards Board (FASB)
- Desire to have established accounting principles stemmed from market crash of 1929
- Multiple agencies created throughout the years to enforce these principles
- FASB = in charge since 1973
 - Works with private sector in creating, adapting and enforcing these rules

2

2




Role of Securities and Exchange Commission

- SEC requires all public companies **in the United States** to follow GAAP rules when reporting their financial statements
 - Minimum standards companies must include in financial reports
- Failure to follow these rules can result in a public company being removed from an exchange
- GAAP rules standardize accounting definitions, assumptions and methods when it comes to calculating finances, e.g.
 - What is considered "revenue?"
 - Which line item does Research & Development (R&D) costs fall under?
 - What is allowed to be considered a depreciating asset?

3

3




Mission Behind GAAP

- Improve the clarity, consistency and comparability of financial information, e.g.
 - A company's quarter-over-quarter or year-over-year information
 - Financial information between companies in the same sector
 - Whole industries
- With this information, investors can understand how competing companies are doing against each other
- Give investors peace of mind that companies aren't getting creative with their earnings numbers just to boost the share price
 - Designed to keep investors' trust in public market by establishing rules that companies **must** follow when reporting their financial statements

4

4




Non-GAAP Numbers

- No specific definition – any accounting method which is not GAAP
- Metrics that companies are allowed to present to investors **without following GAAP rules**
- However, companies **must disclose to investors** that these additional metrics **do not follow the GAAP rules** and are **open to interpretation**
- A non-GAAP measure is a supplemental figure that adjusts the most directly comparable number determined in accordance with GAAP
- Companies must provide a reconciliation between the adjusted and regular results, i.e., explain the difference between GAAP and non-GAAP figures

5

5




Use of Non-GAAP Numbers

- Non-GAAP numbers are **not** audited (GAAP numbers are audited)
- There is no generally standardized method for calculating non-GAAP financial measures
- Management generally decides which non-GAAP financial measures are used and how they are calculated
- Companies within the same industry may present entirely different non-GAAP financial measures, which may lead to a lack of comparability

6

6




SEC View of Non-GAAP Numbers

- While non-GAAP measures are allowed, the rules for using them are relatively strict
- SEC rules prohibit the use of non-GAAP amounts that are misleading or give the non-GAAP measure undue prominence over the GAAP measure
 - SEC staff members believe that non-GAAP amounts can be both confusing and troubling
- Investors should always take non-GAAP metrics with a “grain of salt” because they can be used in a misleading manner

7

7




“While your chief financial officer and investor relations team may be quite enamored of non-GAAP measures as useful market communication devices, your finance and legal teams, along with your audit committees, should carefully attend to the use of these measures and consider questions such as:

- Why are you using the non-GAAP measure, and how does it provide investors with useful information?
- Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules?
- Are your explanations of how you are using the non-GAAP measures – and why they are useful for your investors – accurate and complete, drafted without boilerplate?
- Are there appropriate controls over the calculation of non-GAAP measures?”

Chair Mary Jo White, Keynote Address at the 2015 AICPA National Conference on Current SEC and PCAOB Developments

8

8




SEC Guidance on Use of Non-GAAP Numbers

- A measure could be considered misleading if it:
 - excludes normal, recurring cash operating expenses that are necessary to operate the business; or
 - is presented inconsistently between periods without adequate disclosure of and reason(s) for the change
- Any measure that accelerates revenue recognition is unacceptable and may not be presented publicly (including in SEC filings, in earnings releases, or on company websites)
- A measure is inappropriate in SEC filings and earnings releases if it is presented more prominently than the comparable GAAP measure
- A non-GAAP measure should not be presented net of tax in the reconciliation to the most comparable GAAP measure

9

9




Examples of Inappropriate Presentations

- Presenting a full income statement of non-GAAP measures;
- Omitting comparable GAAP measures from an earnings release headline;
- Presenting a non-GAAP measure using a more prominent or different style of presentation (e.g., bold, larger font);
- Having a non-GAAP measure precede the most directly comparable GAAP measure (including in an earnings release headline);
- Describing a non-GAAP measure as, for example, “record performance” or “exceptional” without an equally prominent descriptive characterization of the comparable GAAP measure;

10

10




Examples of Inappropriate Presentations

- Providing tabular disclosure of non-GAAP financial measures without an equally prominent tabular disclosure or inclusion of the comparable GAAP measures;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure; and
- Providing discussion and analysis of a non-GAAP measure without a similar discussion, analysis, and prominence of the comparable GAAP measure

11

11




Commonly Used Non-GAAP Measures

- Disaggregating different aspects of a company’s operations or removing the effects of large, unusual, or unique transactions, such as acquisitions or dispositions
- Excluding one or more expense or revenue items that are identified as “non-recurring” from operating income – smooths out earnings

12

12




Typical Non-GAAP Measures

- Typical Non-GAAP measures:
 - Earnings before interest and taxes (EBIT)
 - Earnings before interest, taxes, depreciation and amortization (EBITDA)
 - Adjusted revenues
 - Free cash flows
 - Adjusted earnings or earnings per share (EPS)
- Often presented in conjunction with GAAP measures in earnings releases and/or Management’s Discussion and Analysis in Quarterly or Annual SEC filings

13

13




Harley-Davidson, Inc.
Reconciliation of GAAP Amounts to Non-GAAP Amounts
(In thousands, except per share amounts)
(Unaudited)

	Three months ended		Six months ended	
	June 27, 2021	June 26, 2020	June 27, 2021	June 26, 2020
Net income (loss) excluding restructuring plan costs and the impact of EU tariffs				
Net income (loss) (GAAP)	\$ 206,340	\$ (92,217)	\$ 465,484	\$ (22,522)
Restructuring plan costs	918	41,949	552	41,949
Impact of EU tariffs	15,758	5,877	18,719	15,909
Tax effect of adjustments ^(a)	(3,956)	(13,197)	(4,563)	(15,242)
Adjustments net of tax	12,720	34,429	14,708	42,614
Adjusted net income (loss) (non-GAAP)	<u>\$ 219,060</u>	<u>\$ (57,788)</u>	<u>\$ 480,192</u>	<u>\$ 20,952</u>
Diluted EPS excluding restructuring plan costs and the impact of EU tariffs				
Diluted EPS (GAAP)	\$ 1.33	\$ (0.60)	\$ 3.01	\$ (0.15)
Adjustments net of tax, per share	0.08	0.22	0.10	0.28
Adjusted diluted EPS (non-GAAP)	<u>\$ 1.41</u>	<u>\$ (0.38)</u>	<u>\$ 3.11</u>	<u>\$ 0.13</u>

(a) The income tax effect of has been computed using the estimated income tax rate for these adjustments.

14

14



Thank you!

Questions?

15

15