CALCBENCH

Next Generation Financial Data Tools

Non-GAAP Reconciliations Study

In Collaboration with

Suffolk University's

Accounting Winternship Class of 2023

SUFFOLK UNIVERSITY
SAWYER BUSINESS SCHOOL

June 2023

Non-GAAP Reconciliations Study

What we did

For the third year in a row, we examine companies reporting non-GAAP Net Income or non-GAAP Earnings Per Share (EPS). This year we examined the 2022 earnings releases for 200 companies randomly chosen from the S&P 500. We further examine the specific adjustments companies made to reconcile non-GAAP Net Income with GAAP Net Income. We report the findings of this analysis and contrast it with our findings last year, where we examined the 2021 earnings releases for a random sample of 123 companies from the S&P 500.

Key Findings

- Adjusted (non-GAAP) Net Income was higher than GAAP Net Income by an average $1.095B per company, or about 38% of GAAP Net Income.
- When examining non-GAAP reconciliations, we found a total of 1,188 individual reconciling items for our sample, with a total value of almost $219B and an average value of almost $184M per item (an increase of over 53% from last year).
- Companies had an average of 5.9 items per company (compared to an average of 5.8 items per company, last year). Meaning companies had, on average, the same number of adjustments this year as last, but the adjustments were much larger.
- The category of adjustments to GAAP Net Income with the highest value was Impairments, at almost 35% of total adjustments, followed by Amortization of Intangibles, which account for about 27% of total adjustments.
- Average non-GAAP (adjusted) Net Income was almost $4B, very similar to last year's non-GAAP Net Income which was almost $3.8B. Although average GAAP Net Income decreased by 14%, average non-GAAP Net Income, increased by over 4% (see table below).
- These findings continue to question the informative value of as-reported GAAP Net Income and raise questions about companies' motivations in reporting Adjusted Net Income.
- Our sample this year includes some noteworthy adjustments.
    - AT&T (T) which reported a significant adjustment of $24B associated with goodwill impairment of a business in Mexico.[1]
    - Fidelity National Information Services, Inc. (FIS) which reported an adjustment of $17.6B associated with goodwill impairment.[2]
    - Marriott International Inc (MAR) reported two large adjustments to their GAAP NI. They deducted from GAAP NI cost reimbursement revenue of $15.4B and added to GAAP NI reimbursed expenses of $15.1B.[3]
- The 5 companies with the largest adjustments account for almost 37% of total amount adjusted.

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[1] AT&T reports in their earning press release filed 1/25/2023: "Goodwill impairments of $24.8 billion were associated with our Business Wireline, Consumer Wireline and Mexico reporting units and were driven by higher interest rates consistent with the macroeconomic environment, with secular declines also impacting Business Wireline growth rates."

[2] Fidelity included in their earning press release filed 2/13/2023: "Recorded non-cash goodwill impairment charge of $17.6 billion related to Merchant Solutions reporting unit"

[3] Marriot said in their earning press release filed 2/14/2023: "Cost reimbursement revenue includes reimbursements from properties for property-level and centralized programs and services that we operate for the benefit of our hotel owners. Reimbursed expenses include costs incurred by Marriott for certain property-level operating expenses and centralized programs and services."

Companies examined

Sample (from S&P 500)	# of firms	Avg. Market Cap ($ M)	Avg. GAAP Net Income ($ M)	Avg. Difference non-GAAP to GAAP (% of NI) ($ M)	Avg. non-GAAP Net Income ($ M)
2022	200	$63,566 (12/30/2022)	$2,875	$1,095 (38%)	$3,969
2021	123	$80,367 (12/31/2021)	$3,339	$460 (14%)	$3,799

- The average size of companies examined was about $64B (based on end-of-year market cap).[4]
- In our 2022 sample of random firms, non-GAAP Net Income was higher than GAAP Net Income by about 38%.
- In our 2021 sample of random firms, non-GAAP Net Income was higher than GAAP Net Income by about 14%.
- Interestingly, average non-GAAP net income remained relatively the same as last year, showing an increase of 4.5%.

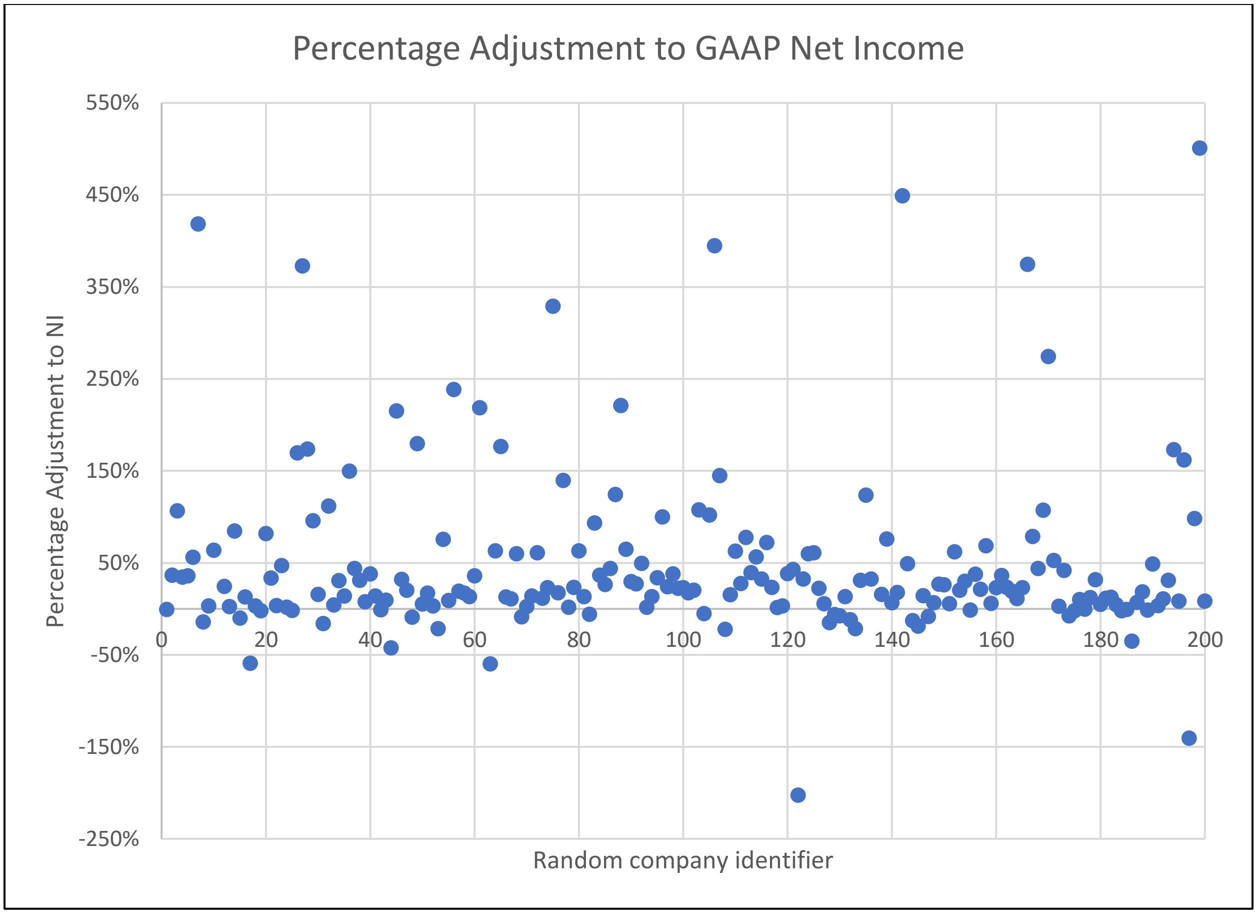
Adjustments Analysis

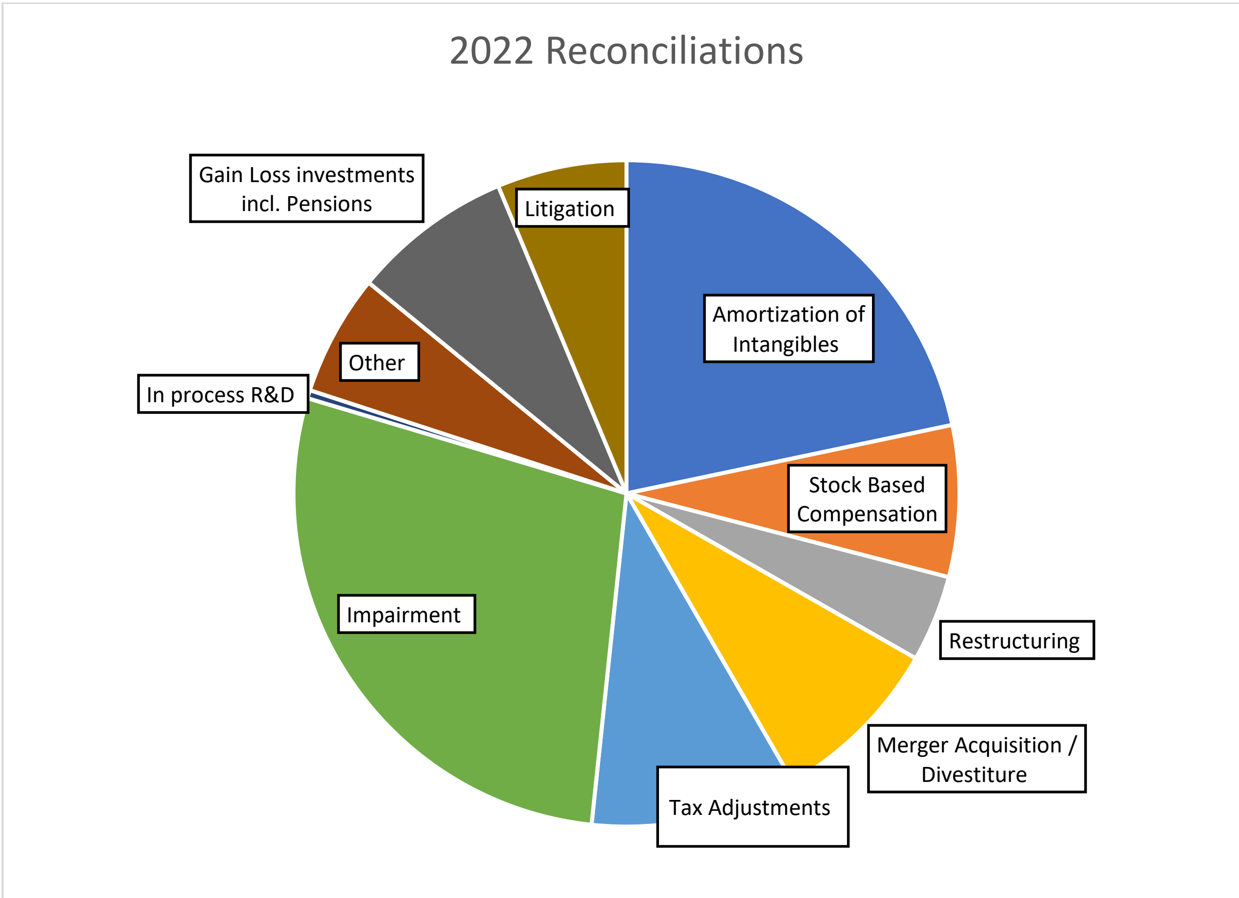
We examine the reconciliation between GAAP and non-GAAP Net Income and study the different reconciling items companies used. We classify the different reconciling items into 11 categories to study how common the different categories are.

- Average individual adjustment to GAAP Net Income was almost $184M (non-GAAP NI was higher). Last year, the average adjustment was about $120M.
- The number of adjustments per company remained roughly the same:
  - An average of 5.94 adjustments per company in this year's sample;
  - An average of 5.8 adjustments per company in last year's sample.
- 83% of companies adjusted non-GAAP income upwards (non-GAAP income is higher than GAAP income), whereas 17% of companies adjusted their non-GAAP income downward (see scatterplot below).
- The scatterplot below shows the range of adjustments as a percentage of GAAP net income. The majority of companies show adjustments of up to 50%, although a third of companies show (positive) adjustments of more than 50% to GAAP net income, and 16.5% adjusted GAAP net income upwards more than 100%.[5]
- Impairments constitutes the largest category of adjustments accounting for over a third of total amount adjusted (last year impairments accounted for only 8% of total amount adjusted).
- Amortization of intangibles is now the second largest category (27% of total amount adjusted this year, compared to 50% in last year's sample).
- For more details see category tables below.

[4] This decrease of about 20% from last year is consistent with the overall decrease of the S&P 500 index in the same period.

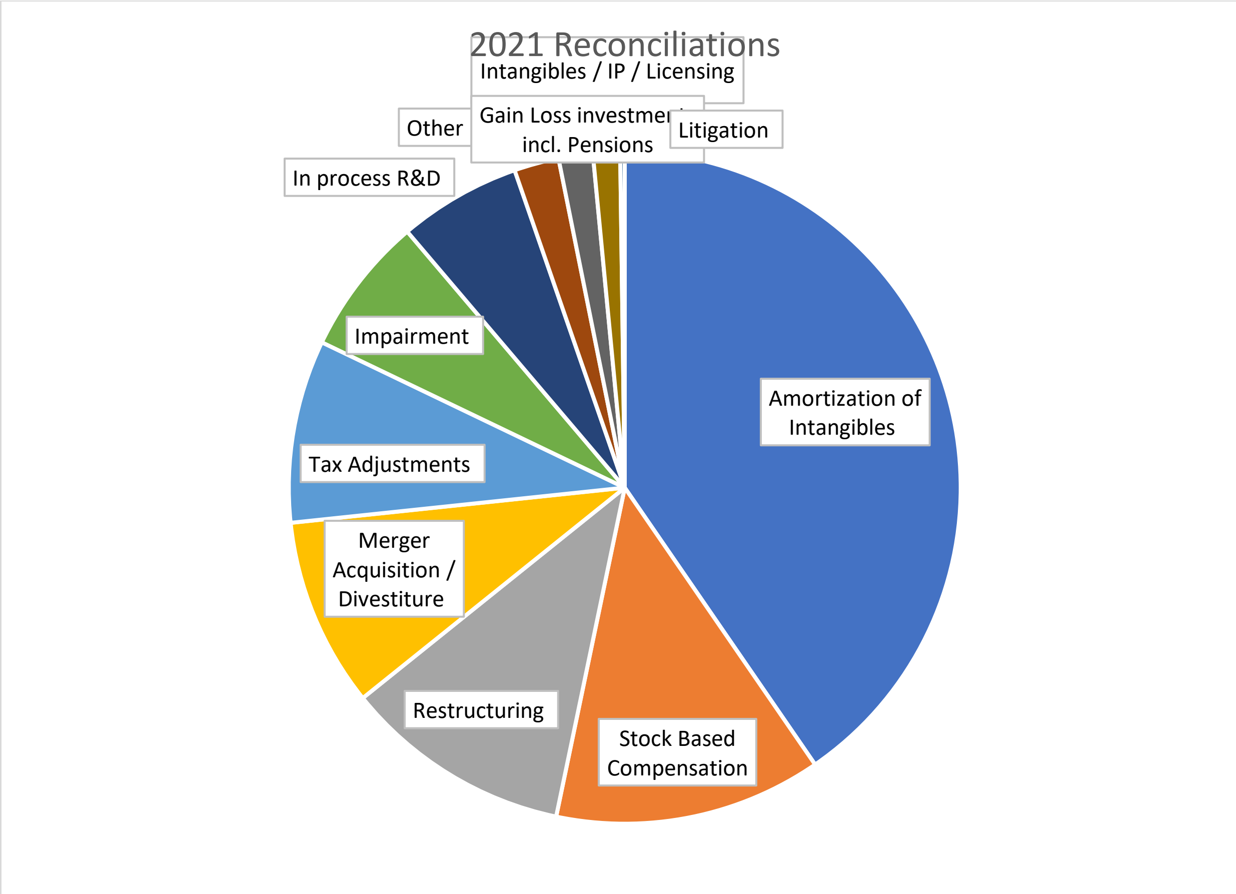
[5] Two companies in our sample are outside the range shown in the scatterplot. Constellation Brands, Inc. (STZ) had a decrease of 5,313% to GAAP Net Income and Alaska Air Group, Inc. (ALK) had an increase of 2,348% to GAAP Net Income.


Percentage Adjustment to GAAP Net Income
550%
450%
350%
250%
150%
50%
-50%
-150%
-250%
0
20
40
60
80
100
120
140
160
180
200
Percentage Adjustment to NI
Random company identifier



2022 reconciliations

Category	Adjustment Count	Dollars Adjusted (in millions USD)	Percent of Total	Average Adjustment (in millions USD)
Amortization of Intangibles	88	59,402	27.13%	675
Stock Based Compensation	43	20,109	9.18%	468
Restructuring	97	11,493	5.25%	118
Merger Acquisition / Divestiture	170	23,065	10.53%	136
Tax Adjustments	191	(27,381)	-12.50%	(143)
Impairment	72	76,480	34.93%	1,062
In process R&D	2	1,091	0.50%	546
Other	286	16,126	7.36%	56
Intangibles / IP / Licensing	0	0	0.00%	0
Gain Loss investments incl. Pensions	195	21,353	9.75%	109
Litigation	44	17,229	7.87%	392
Total	**1188**	**218,966**	**100.00%**	**184**



2021 reconciliations

Category	Adjustment Count	Dollars Adjusted (in millions USD)	Percent of Total	Average Adjustment (in millions USD)
Amortization of Intangibles	64	43,505	50.63%	680
Stock Based Compensation	29	13,838	16.11%	477
Restructuring	48	11,799	13.73%	246
Merger Acquisition / Divestiture	71	9,794	11.40%	138
Tax Adjustments	112	(9,458)	-11.01%	(84)
Impairment	36	7,183	8.36%	200
In process R&D	12	6,339	7.38%	528
Other	185	2,320	2.70%	12
Intangibles / IP / Licensing	6	1,769	2.06%	295
Gain Loss investments incl. Pensions	128	(1,398)	-1.63%	(11)
Litigation	27	230	0.27%	9
Total	**718**	**85,922**	**100.00%**	**120**

What does it mean?

- The vast majority of companies in our sample (83%) adjust the Net Income upwards. Companies might adjust GAAP earnings for several reasons:
    - The adjusted (non-GAAP) earnings are more informative and useful for investors.
    - Companies are trying to show more positive results than presented by the GAAP earnings.
    - Companies may be attempting to smooth earnings to show a more consistent profitability over time.
- We cannot speculate whether the increase in the non-GAAP adjustments was intentional to produce a relatively constant non-GAAP Net Income, whether there was an attempt to smooth earnings or whether this is merely a coincidence.
- The main question still remains whether non-GAAP earnings are indeed more informative than GAAP earnings in predicting the company's future performance and value or whether non-GAAP adjustments are used by companies to "window dress" the results of their operations.
- Adding back the amortization expense of intangible assets continues to be a common practice when adjusting GAAP Net Income.
    - 43% of companies in our sample (87 firms) included that adjustment in their calculation of non-GAAP Income.
    - Does this mean that the amortization of intangibles is not useful information for investors? Would adjusting GAAP Net Income to exclude the amortization make the adjusted Net Income more useful?
    - If that is the case, should GAAP accounting rules change and not require the amortization of intangibles? Should they just be tested annually like goodwill? Maybe this change should be only for certain industries (for example the pharmaceutical industry)?

Transitory vs. permanent

- Recurring earnings items are typically more significant in predicting a company's future earnings and assessing its value. A common approach to evaluating companies' earnings is separating transitory and permanent items.
- Some of the adjustment categories are more likely to be transitory (for example, Restructuring, Merger& Acquisition, or Divestiture). This would suggest that adjusting for those items may eliminate more transitory items from reported earnings.
- Some of the adjustment categories are more likely to be permanent (such as Amortization of Intangibles, Stock-Based Compensation, or even Tax Adjustments). If these are permanent items, eliminating them would not produce more informative earnings.
- Should companies disclose why they think the tax adjustments are unusual and transitory so investors can better evaluate them?

About this report

This report was prepared by Calcbench in collaboration with Suffolk University's Accounting Winternship Class of 2023, led by Associate Dean Tracey Riley and Professor Regina O'Neil. Students participating in the report include: Nicole Bartolomeo, Byron Deily, Boston Emmanuel, Leah Fabiano, Daniel Ferrara, Kate Kantzelis, Kathryn Krobot, Aron Librea, Michelle Nguyen, Thao Nguyen, April Nickerson, and Michelle Riley.