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Looking at EBITDAC

By Olga Usvyatsky

The term EBITDAC (Earnings Before Interest, Taxes, Depreciation, Amortization and Coronavirus) was, until recently, just a common accounting joke among those who criticize excessive use of non-GAAP metrics.

Yet, a recent FT article suggests that some companies may indeed present EBITDAC among metrics that remove COVID-19 related expenses. The FT article raises several interesting questions. Is the EBITDAC metric an emerging trend or just an anomaly, and what types of expenses are included in the "C" component?

A quick search for "COVID-19 related expenses" using Calcbench's "Disclosures & Footnotes Query" tool returned more than 40 companies that included COVID-19 related costs as a separate line in the Adjusted EBITDA or Adjusted Net Income reconciling tables. A small number of findings suggests that while it is not really a one off, such a disclosure is still relatively infrequent.

In many cases, the COVID-19-related adjustments were related to direct expenses of the pandemic, such as protective gear, cleaning supplies and IT-related equipment used to facilitate working from home.

Quantitatively, the COVID-19 adjustments ranged from a few hundreds of thousands of dollars for some of the smaller companies to millions of dollars for larger firms. Obviously, the magnitude is always relative to the size of the operations. The median adjustment in the sample examined was about $1.2 million, while the average was approximately $15 million.

To illustrate, let's look at Dexcom Inc. (DXCM), a developer of glucose monitoring systems. Dexcom included $3.2 million of COVID-19 expenses in the calculation of Non-GAAP Net Income and Adjusted EBITDA metrics and explained that the costs were related to "taking the necessary precautions for essential personnel to operate safely both in person as well as remotely." Costs incurred included payroll costs, consulting support and IT-related costs.

In another example, T-Mobile US, Inc. (TMUS), a wireless network operator, excluded $117 million of COVID-19 related costs from the calculation of Adjusted EBITDA stating that pandemic-related and some other expenses are "not reflective of T-Mobile's ongoing operating performance."

Notably, the examples above should not be interpreted as if the adjustments were recorded in an incorrect or inappropriate way. Back in March, the SEC issued a statement clarifying that the Commission understands that some companies may need to present new metrics or modify existing

metrics related to the pandemic and noted that the disclosure needs to comply with the previously issued non-GAAP guidance.

One provision, of the past non-GAAP, that could possibly be applicable to some companies is describing the adjustments as one-time or non-recurring. In some cases, the pandemic disrupted the normal course of business in an unprecedented way and expenses such as additional safety equipment could arguably be unusual. Yet, Question 102.03 of the SEC's 2018 Compliance and Disclosure Interpretations (CD&Is) states that adjustments could be described as non-recurring only if the charges or gains are unlikely to recur within two years. Recurring adjustments could still be presented, subject to Regulation G requirements, but cannot be described as "non-recurring, infrequent or unusual." In lay terms, if the pandemic environment extends to 2021 and beyond, companies may need to reconsider the "non-recurring" description of the pandemic costs.

A separate non-GAAP line is not the only way to communicate the impact of COVID-19. Instead, some companies chose to quantify the impact without adjusting non-GAAP results. For example, in an April 22 8-K filing, AT&T (T) estimated that the impact of the COVID-19 costs was $0.05 per share and noted that more than half of those costs are likely to have short-term impact.[1]

Going back to the general non-GAAP presentation, COVID-19 related impact is not limited to direct costs of protecting the employees. Let's look at some of the most common non-GAAP items that are likely to be affected by COVID-19 costs.[2]

First, let's consider a hypothetical company that, following a lockdown, had to scale back operations. Restructuring charges frequently include costs such as severance packages and other costs associated with the reduction of business activity. Quantifying the impact of costs directly attributed to COVID-19 might not be an easy task. Additional restructuring costs for such a company are likely to be included in the non-GAAP restructuring adjustments.

Next, let's think about how an economic slowdown affects the fair value of assets, including goodwill and other intangibles. In Q1 of 2020, Calcbench identified 51 firms in the S&P 500 that recorded $61.45

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[1] This analysis does not aim to explore whether one type of presentation is preferable to another. A recent survey by Bass, Berry & Sims looked into determinants of why some companies may lean toward a particular presentation.

[2] According to past analysis by Audit Analytics, Restructuring and Goodwill and Intangibles impairments are two of the most common types of non-GAAP adjustments.

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billion in impairments. Many of these firms are likely to adjust for goodwill impairments when calculating the non-GAAP metrics.

To summarize, some expenses may be absorbed in other reconciling items and not presented as a standalone COVID-19 related cost.

Although infrequent, the COVID-19 related non-GAAP expenses that are presented separately are still noteworthy. Non-GAAP metrics aim to present financial results through the eyes of the management. A separate reconciling item could arguably be an indicator of an element that is important to the company.

Covid-19 adjusted metrics recently came into the spotlight for another reason. A recent media report suggested that some companies may use extensively modified metrics to bypass covenant restrictions and raise the debt levels beyond sustainable. We cannot state with certainty why managers modify the metrics for the coronavirus (or any other) adjustments. Yet, it is not implausible to assume that the calculations of the metrics could be scrutinized by the lenders.

Some of the industries such as airlines and other travel-related businesses suffered from a severe business downturn in Q1 2020. Others may see a stronger impact in subsequent quarters of the year, incurring substantial pandemic-related expense in Q2 and beyond. From the reporting perspective, we may see more companies include COVID-19 expenses as a separate reconciling line in their non-GAAP disclosures.

About Olga Usvyatsky

Olga Usvyatsky is currently a PhD student at Boston College. She was formerly a Vice President at Audit Analytics. Ms Usvyatsky has more than 15 years of experience in data-driven analysis. Her work has been featured in the WSJ, MarketWatch and other media outlets.