



## Non-GAAP Financial Measures

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May 20, 2017



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## Non-GAAP Financial Measures The Nerello Corporation

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### ***Background***

- Nerello is a logistics and financial reporting software platform offering several cloud based solutions to companies in domestic and foreign markets.
  
- Nerello has acquired many companies over the last several years and is increasingly frustrated by the perceived inability to inform the investing public of its success in presenting a comprehensive suite of solutions to its current and potential customers and investors.
  
- In its MD&A, the company has provided its investors a comprehensive set of adjusted or Non-GAAP financial measures in addition to its GAAP financial statements.



## The Nerello Corporation Non-GAAP Financial Measures Used and Management Rationale

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- **Amortization of acquired intangibles:** The exclusion of amortization expense provides a more consistent measure of operating results.
- **Acquisition costs and fees:** The non-recurring nature and varied components of these costs distort our operating results.
- **Stock-based compensation expense:** GAAP requires the use of several inconsistent valuation and measurement methods that combined with varying economic conditions around a multitude of grant date fair values significantly reduce the value of this measure.



## The Nerello Corporation Non-GAAP Financial Measures Used and Management Rationale

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- **Certain impairment and restructuring charges:** The losses recognized for fixed assets, restructured lease commitments for our data centers, and workforce realignments are non-recurring and their elimination provides more value-relevant operating results
  
- **Gains and losses on investments:** These gains and losses are infrequent and their elimination allows us to better report results of continuing operations.
  
- **Tax effect of Non-GAAP Financial measures:** Inclusion of the tax consequences of non-recurring and non-representative items listed above enables us to better represent the actual long-term trend in tax expenses and cash taxes paid.



## The Nerello Corporation Reconciliation – Income from Operations (in thousands)

	2016	2015	2014
Income from operations	\$ 520,241	\$ 554,450	\$570,009
Amortization – acquired intangibles	31,587	32,350	24,200
Stock-based compensation	178,241	139,252	113,987
Acquisition costs and fees	5,726	1,024	3,457
Restructuring and impairment charges	19,659	1,900	9,524
Non-GAAP Income from operations	\$ 755,454	\$ 728,976	\$ 721,177



## The Nerello Corporation Margins

	2016	2015	2014
Income from operations	\$ 520,241	\$ 554,450	\$ 570,009
Non-GAAP Income from operations	\$ 755,454	\$ 728,976	\$ 721,177
GAAP operating margin	19.2 %	20.7 %	22.3%
Non-GAAP operating margin	26.1%	27.3 %	27.1 %



## The Nerello Corporation Reconciliation – Net Income (in thousands)

	2016	2015	2014
Net income	\$ 312,245	\$ 309,257	\$ 342,159
Amortization – acquired intangibles	31,587	32,350	24,200
Stock-based compensation	178,241	139,252	113,987
Acquisition costs and fees	5,726	1,024	3,457
Restructuring and impairment charges	16,259	1,360	7,200
Gains and losses on investments	3,400	540	2,324
Tax effect of Non-GAAP items	(58803)	(436632)	(37792)
Non-GAAP Net income	\$ 488,655	\$ 440,152	\$ 455,535



## The Nerello Corporation Reconciliation - EPS

	2016	2015	2014
GAAP Net income per share	\$ 1.95	\$ 1.83	\$ 2.01
Amortization – acquired intangibles	0.20	0.19	0.14
Stock-based compensation	1.12	0.82	0.67
Acquisition costs and fees	0.04	0.01	0.02
Restructuring and impairment charges	0.10	0.01	0.04
Gains and losses on investments	0.02	0.00	0.01
Tax effect of Non-GAAP items	(.37)	(0.26)	(0.22)
Non-GAAP Net income per share	\$ 3.06	\$ 2.60	\$ 2.68
Weighted Average Shares in EPS	159,898	169,347	170,252





## The Nerello Corporation Reconciliation - EBITDA (in thousands)

	2016	2015	2014
Net income	\$ 312,245	\$ 309,257	\$ 342,159
Amortization – acquired intangibles	31,587	32,350	24,200
Stock-based compensation	178,241	139,252	113,987
Acquisition costs and fees	5,726	1,024	3,457
Restructuring and impairment charges	16,259	1,360	7,200
Gains and losses on investments	3,400	540	2,324
Provision for Taxes	141,552	130,108	148,854
Depreciation and amortization	290,314	174,249	156,989
Other (income) expense, net	(3,412)	2,714	1,324
Adjusted EBITDA	\$ 975,912	\$ 790,853	\$ 800,494
Adjusted EBITDA margin	40%	40%	42%



## The Nerello Corporation Discussion

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- Is the MD&A the appropriate place for the discussion of Non-GAAP measures?
- Do these disclosures provide value-relevant information?
- Does the liquidity measure used provide useful information?



## The Nerello Corporation Discussion

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- Impact on comparative analysis?
- Do Non-GAAP measures contribute to a better or more comprehensive understanding of management, governance, or other relevant indicators of performance?



## The Nerello Corporation Discussion

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- Should standard-setters prescribe definitions of Non-GAAP measures?
- Should NGFM be given equal prominence?



## The Nerello Corporation Discussion

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- Should NGFM be audited?
  
- If yes, should all NGFM, regardless of how disclosed or presented, be audited?



## The Nerello Corporation

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- The Nerello Corporation was acquired in May 2017. The venture capital (VC) firm acquiring the company will use leveraged loans to pay for a significant portion of the purchase price.
  
- The VC reports a revised adjusted EBITDA for 2016 of \$1.42 billion.
  
- The increase is a result of 3 adjustments:
  - Inclusion of future licensing revenue
  - Revised valuation of stock compensation
  - Application of a March 2017 price increase to the 2016 period



## The Nerello Corporation

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- A regulatory leverage guideline is designed to restrict lending to no more than 6 times a company's EBITDA.
- Leveraged loans are not subject to SEC oversight.
- Federal examiners have raised concerns about the leveraged loans in a few recent acquisitions.



## The Nerello Corporation Discussion

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- Leveraged loans are generally sold to sophisticated investors, money managers, and mutual funds. Do we need regulation in private loan markets?
- Consider the impact of leveraged loans on risks in acquisition markets
- Impact of NGFM on valuation and liquidity risks in capital markets?