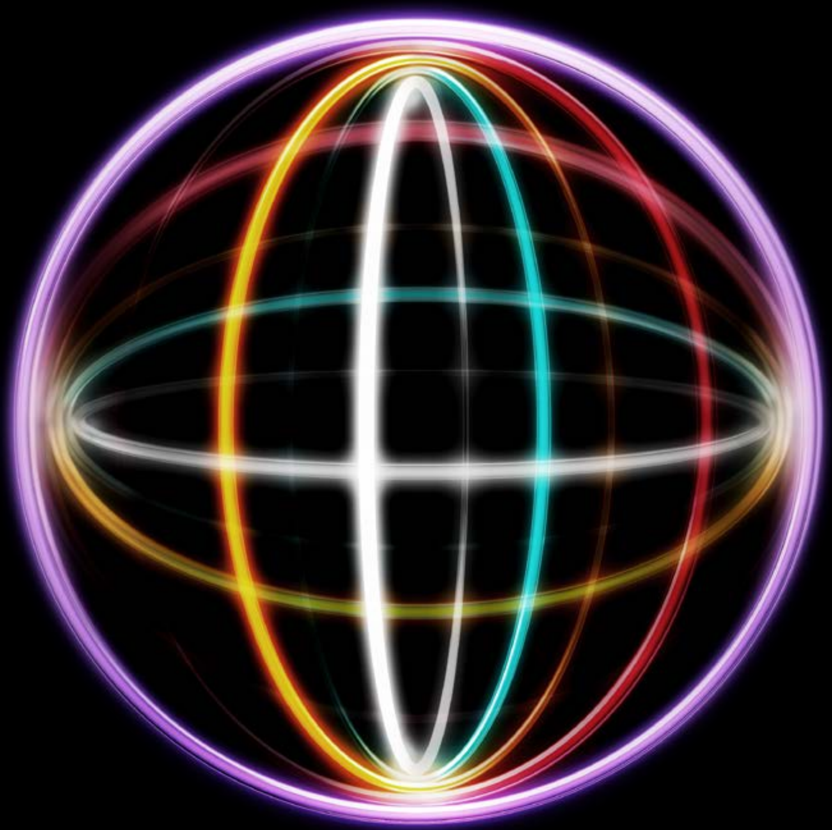
Deloitte.



Non-GAAP Financial Measures

Mark Miskinis, Partner, SEC Services

AGENDA

Background

Definition and examples of Non-GAAP Measures

Why do companies use Non-GAAP measures?

SEC Rules and Interpretations

Recent areas of SEC focus and changes in Non-GAAP disclosures

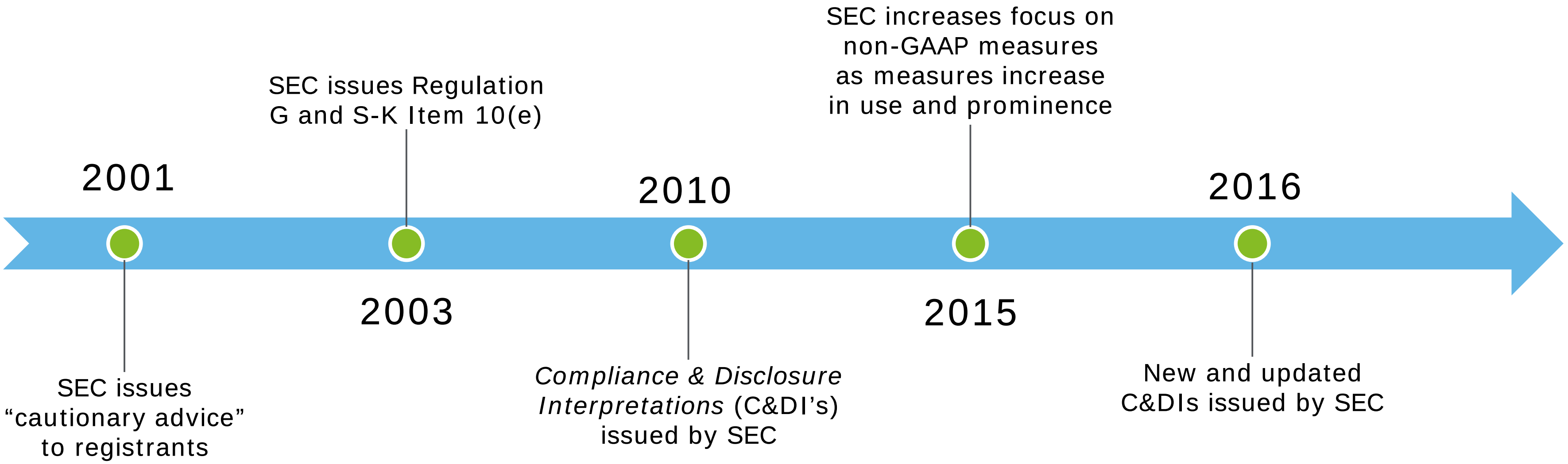
Looking forward

Non-GAAP measures

Background

Non-GAAP measures

Evolution of non-GAAP measure rules and regulations



Non-GAAP measures
Definition under SEC Rules

A numerical measure of a registrant's *historical or future* financial performance, financial position or cash flows that:

- *Excludes* amounts...that are *included* in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or
- *Includes* amounts...that are *excluded* from the most directly comparable measure so calculated and presented".

The definition of a non-GAAP financial measure is intended to "capture all measures that have the effect of depicting either:

- [A] measure of <u>performance</u> that is different from that presented in the financial statements, such as income or loss before taxes or net income or loss, as calculated in accordance with GAAP; or
- [A] measure of <u>liquidity</u> that is different from cash flow or cash flow from operations computed in accordance with GAAP."

Non-GAAP measures

GAAP or Non-GAAP?

Common Non-GAAP Measures:

- EBITDA and Adjusted EBITDA
- Adjusted Net Income
- Adjusted EPS
- Free Cash Flow

GAAP or Non-GAAP?

- Operating Earnings
- EBIT
- Net Sales
- Revenue from 10 largest customers
- Revenue excluding acquisitions (Organic Revenue)
- Total Billings
- System-wide Franchise Revenue
- Segment Adjusted EBITDA
- Restructuring cost per share
- Net Debt
- Constant Currency amounts

Non-GAAP measures

Items that are NOT considered non-GAAP financial measures

Statistical Measures based solely on GAAP amounts

- Gross profit margin or operating margin

Statistical Measures based on GAAP amounts and non-financial information

- Same store sales

Presentation of components of a GAAP line item

- Revenue by Product Line

Any measure expressly required by GAAP or SEC rules

- Segment profitability measure

Non-GAAP measures
Common adjustments

Some of the more common adjustments include:

- EBITDA related
- Stock compensation
- Restructuring costs
- Impairments
- Legal settlements
- Acquisition-related costs
  - Direct costs of acquisition
  - Amortization of intangibles
  - Integration costs
- Investment gains and losses
- Pension-related
- Tax related adjustments

Non-GAAP measures
Alternative presentations

The following table summarizes unallocated operating expenses and certain items impacting comparability:

	Year Ended December 31, 2016	2015
	(in millions)	
Spinoff-related transaction expenses	$ 7.1	—
Restructuring and impairment charges	$ 11.4	$ 6.2
Acquisition-related expenses	$ 2.6	$ 0.5
Loss on disposition of business	—	$ 6.2
Litigation settlement (gain)loss	$ (12.6)	—
Pension settlement charges	$ 16.1	—
Total	$ 24.6	$ 12.9

Non-GAAP measures

Why do companies present Non-GAAP measures

Non-GAAP measures may:

- Provide additional insight into operations that GAAP does not provide
- Provide more meaningful period-to-period comparisons and analysis of trends
- Represent normalized or "core" operations
- Assist investors in viewing a company's operations consistently with the way management does in budgeting, management compensation
- Be utilized in calculating Debt Covenants
- Provide consistency with peer companies
- Be requested by analysts

Are there other reasons?

- Issues with GAAP?
- Inherent bias?

Non-GAAP measures

The Rules

SEC Rule	Overview of the requirements

Regulation G	• Non-GAAP financial measures must not be misleading.
	• The most directly comparable GAAP measure must be presented.
	• A quantitative reconciliation of the non-GAAP financial measure to the most comparable GAAP measure must be presented for:
	  − a historical non-GAAP measure and
	  − forward-looking information (to the extent available without unreasonable effort)

Item 10(e) of Regulation S-K	Expands upon Reg. G requirements to also include: • Present most directly comparable GAAP measure <u>with greater or equal prominence</u> of that of the non-GAAP measure • Disclosure indicating why the registrant believes that the non-GAAP measure is useful to investors • Disclosure of the additional purposes, if any, for which the registrant uses the non-GAAP measure

Non-GAAP measures
Additional prohibitions

- Excluding “charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than [EBIT and EBITDA]” (the “liquidity measure prohibition”).
- Adjusting “a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when” (1) the nature of the charge or gain is such that it is reasonably likely to recur within two years or (2) there was a similar charge or gain within the prior two years (the “performance measure prohibition”).
- Presenting “non-GAAP financial measures on the face of the registrant’s financial statements prepared in accordance with GAAP or in the accompanying notes”.
- Presenting “non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X.”
- Using “titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.”
- Presenting per-share measures of liquidity

Non-GAAP measures

Updated Compliance and Disclosure Interpretations

Examples of non-GAAP measures presented with excessive prominence (C&DI 102.10)

- Non-GAAP measures in press release headlines w/o GAAP comparable
- Non-GAAP measure in bolder or larger font than GAAP
- Non-GAAP measure that precedes a comparable GAAP measure
- Descriptive comments only for a non-GAAP measure (e.g. "record performance")
- More discussion and analysis of non-GAAP measures than GAAP measures
- Tabular disclosure/reconciliation that starts with a non-GAAP measure
- A full non-GAAP income statement
- Omitting disclosures related to forward looking non-GAAP measures

"Non-GAAP measures are intended to supplement ...and not supplant the information in the financial statements."
-Jim Schnurr, Former Chief Accountant, Office of the Chief Accountant

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Prominence: When a registrant presents its non-GAAP financial measures more prominently than its GAAP measures (e.g., the registrant presents them before, or places greater emphasis on them than its GAAP measures, or presents a full non-GAAP Income Statement).

Sample comments:

1. We note that in your executive summary you focus on key non-GAAP financial measures and not GAAP financial measures which may be inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016 (specifically Question 102.10). We also note issues related to prominence within your earnings release . . . . Please review this guidance when preparing your next earnings release.

2. We note that your reconciliation of EBITDA starts with the non-GAAP measure and reconciles to the GAAP measure (net income). In future filings please revise your presentation to start with the GAAP measure so that the GAAP measure is presented with equal or greater prominence. This comment also applies to any non-GAAP measures presented in an earnings release. Refer to Question 102.10 of the Compliance and Disclosure Interpretations

Non-GAAP measures
Full non-GAAP income statement

Example

Company X presented a summary of its statement of operations in its first quarter 20X6 earnings release. To arrive at its "ongoing" operations, X presented its line items on a GAAP as-reported basis as well as adjustments to various expense items that it believes should be excluded. Although not all line items from the historical statement of operations in the "as-reported" column have been adjusted, such presentation may represent a full non-GAAP income statement and could be prohibited:

	As Reported	Adjustments	Ongoing
Sales	$ 300	$ —	$ 300
Cost of goods sold	100	(20)	80
Gross profit	200	(20)	220
Operating expenses	75	(25)	50
Operating income	125	45	170
Interest expense	10		10
Other nonoperating expense	10	(5)	5
Pretax income	105	50	155
Taxes	25	10	35
Net income	$ 80	$ 40	$ 120

Non-GAAP measures
Updated Compliance and Disclosure Interpretations

Financial measures using individually tailored accounting principles (C&DI 100.4)

- Using a registrants' own set of accounting principles to determine a non-GAAP measure
- Most often seen with adjusted revenue
- Staff may not object to a measure that adjusts to reflect the adoption of the new revenue recognition accounting standard

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Individually tailored revenue adjustment:

Sample comment:

The adjustment “change in deferred amusement revenue and ticket liability” in arriving at your non-GAAP measure “adjusted EBITDA” <u>appears to accelerate the recognition of revenue</u> associated with the deferred amusement and ticket liability that otherwise would not be recognized in any of the periods for which adjusted EBITDA is presented. Accordingly, adjusted EBITDA substitutes a tailored revenue recognition method for that prescribed by GAAP and does not comply with Question 100.04 of the staff’s Compliance & Discussion Interpretations on Non-GAAP Financial Measures. Please remove this adjustment from your computation.

Non-GAAP measures
Updated Compliance and Disclosure Interpretations

Potentially misleading measures (C&DI 100.01–100.03, 102.03)

- Adjusting for normal recurring cash operating expenses in a performance measure
- Inconsistent adjustments between periods without proper disclosure
- Cherry picking (i.e. excluding only non-recurring costs but not non-recurring gains)
- Adjusting to eliminate or smooth items identified as non-recurring, infrequent or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years.

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Nature of adjustments: Comments on the nature of reconciling adjustments and the related disclosures.

Sample comments:

1. We note that your non-GAAP measures exclude purchased intangible amortization, restructuring costs, asset impairments, acquisition-related costs, and income tax items and that <u>you describe these items as infrequent or unusual although you have reported similar items for multiple fiscal years</u>. Please note that Item 10(e)(1)(i)(A) of Regulation S-K prohibits you from adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. In addition, your non-GAAP measures appear to <u>exclude certain normal, recurring, cash operating expenses</u> which is inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please review this guidance when preparing your next earnings release.

2. Given that your ongoing acquisition of businesses is a critical strategy you employ to achieve and maintain growth in your business, please tell us why you remove the impact of acquisition-related expenses and the amortization of intangible assets you acquire, as well as the impact of other fair value adjustments recorded under acquisition accounting in presenting your non-GAAP financial measures.

Non-GAAP measures
Updated Compliance and Disclosure Interpretations

Prohibition on presenting liquidity measures on a per share basis (C&DI 102.05)

- Designated performance measures that are really liquidity measures
- Prohibition depends on whether the non-GAAP measure can be used as a liquidity measure
- SEC focus on the substance of the non-GAAP measure and not management’s characterization of the measure

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Liquidity or performance measure:

Sample comments:

1. You disclose that you believe the non-GAAP measures presented, including Adjusted EPS, allow investors to gain a better understanding of the factors and trends affecting the ongoing cash earnings capabilities of your business for which capital investments are made and debt is serviced. From this it appears the non-GAAP measures are intended to be measures of liquidity. Presenting non-GAAP liquidity measures on a per share basis is not consistent with 102.05 of staff's Compliance and Disclosure Interpretations on Non-GAAP Financial Measures. Please review this guidance when preparing your next earnings release.

2. Given the nature and magnitude of the vast majority of your non-GAAP adjustments, it appears that your non-GAAP adjusted net income is actually a non-GAAP liquidity measure. As such, please tell us why this non-GAAP measure is not a liquidity measure or represent to us that you will no longer present this measure on a per share basis. Please see Compliance & Disclosure Interpretation on Non-GAAP Financial Measures, or CDI, Question 102.05. non-GAAP financial measures.

Non-GAAP measures

Updated Compliance and Disclosure Interpretations

Non-GAAP tax expense (C&DI 102.11)

- Tax adjustments commensurate with the non-GAAP measure of profitability
- Clear explanation of how the adjustment was determined
- Cash tax adjustments
- “Normalized” tax rates

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Impact of income taxes: Comments on the calculation of the tax impact of non-GAAP adjustments and the related disclosures.

Sample comments:

1. Please expand your disclosures to explain how you calculated the tax effect for the adjustments to net (loss) income attributable to . . . and per diluted share in accordance with the guidance in Question 102.11 of the Non-GAAP Financial Measures Compliance & Disclosure Interpretations.

2. Tell us why you believe that removal of non-cash income taxes and not reflecting income taxes on non-GAAP adjustments in arriving at non-GAAP adjusted earnings is appropriate. Refer to question 102.11 of our Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2017.

Non-GAAP measures

Most recent trends

- Most companies have addressed prominence issues
- SEC looking for greater detail in purpose and use disclosures
- Improve clarity in reconciliations
- Challenges on Liquidity vs. Performance measures
- Additional focus on:
  - Recurring cost adjustments
    - Restructuring expenses and legal settlements
  - Measures using individually tailored accounting principles
    - Considering areas other than revenue
  - Subjective adjustments
    - Synergies and cost savings

Non-GAAP measures

SEC comment letter trends—Recent areas of focus

Purpose and use: Includes comments on whether the disclosures demonstrate the purpose of the measures (i.e., their usefulness to investors and how management uses them).

Sample comment:

Please revise to disclose the reasons why you believe your presentation of each of the non-GAAP financial measures provides useful information to investors regarding your financial condition and results of operations. The justification for the use of the non-GAAP financial measure must be substantive. Merely indicating that you provide such non-GAAP financial measures to give investors additional data to evaluate your operations is not sufficient support for disclosure of the non-GAAP financial measures. Please also revise to expand your disclosure of the additional purposes for which management uses each of the non-GAAP financial measures. Please refer to Item 10(e) of Regulation S-K.

Non-GAAP measures
Disclosure controls and procedures

Disclosure Controls and Procedures (DCPs) Vs. Internal Control Over Financial Reporting

Design DCPS to ensure that procedures cover:

Compliance	NGM presented in compliance with rules, regulations and guidance
Consistency	Adjustments evaluated and presented in an appropriate and consistent manner each period
Data quality	Calculated based on reliable inputs
Accuracy	Calculation is arithmetically accurate
Transparent disclosure	Descriptions of adjustments and required disclosures are clear and not confusing
Review	Reviewed by the appropriate levels of management
Monitoring	Internal audit, disclosure committee or audit committee reviews the controls or is involved in the oversight

Non-GAAP measures
Impetus for additional changes

- SEC comment process and/or enforcement
- Auditor association
- Management and Board of Directors
- Investor or Analyst pressures

Non-GAAP measures
Auditor's role

Current role:

Association related procedures

Agreed-upon procedures (if requested by client)

Possible Future roles:

Attestation of non-GAAP measures

Supplemental information under Audit Standard 17, Supplemental Information Accompanying Audited Financial Statements

Non-GAAP measures
Metrics or Key Performance Indicators (KPIs)

What are KPI’s?

- Non-financial data-points
  - Number of on-line users
  - Web page clicks
  - Customer retention rates

- Ratios or statistical measures based on data points and financial measures
  - Same store sales
  - Revenue per customer
  - Rental rates per square foot

Non-GAAP measures

Metrics or Key Performance Indicators (KPIs)

What are the rules around KPI’s?

- Not subject to Reg G or Item 10(e) unless based on a non-GAAP measure

- SEC suggests registrants:
  - clearly define the metrics used and how they are calculated
  - describe any important assumptions and limitations (e.g., whether the metric is a “hard” amount or an estimate)
  - present a metric within a balanced discussion
  - clearly describe how a metric is related to current or future results of operations
  - consider controls around metrics

SEC Comment Letter Trends: Overall Summary

Twelve Months ended July 31, 2016

Topic	Percentage of All Reviews	Rank	Change in Rank From Prior Year
MD&A		1	—
Results of operations	23%		
Liquidity	11%		
Critical accounting policies and estimates	9%		
Contractual obligations	3%		
Non-GAAP measures	23%	2	↑ 1
Fair value	18%	3	↓ 1
Segment reporting	14%	4	↑ 3
Income tax	13%	5	↑ 1
Revenue recognition	13%	6	↓ 2
Intangible assets and goodwill	12%	7	↑ 1
Signatures, exhibits, or agreements	8%	8	↓ 3
Acquisitions, mergers, and business combinations	8%	9	—
ICFR	8%	10	↑ 4

Comment Letter trend information was derived from data provided by Audit Analytics based on the percentage of all comment-letter-yielding Form 10-K and 10-Q reviews that include a comment on topic.

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