CALCBENCH

Next Generation Financial Data Tools

Non-GAAP Reconciliations Study

In Collaboration with

Suffolk University's

Accounting Winternship Class of 2024

SUFFOLK UNIVERSITY
SAWYER BUSINESS SCHOOL

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Non-GAAP Reconciliations Study

What we did

For the fourth year in a row, Calcbench and Suffolk University examined companies reporting non-GAAP Net Income or non-GAAP earnings per share (EPS) to understand how companies reconciled those numbers back to U.S. Generally Accepted Accounting Principles (GAAP).

This year we examined the 2023 earnings releases for 260 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 from the prior two years, when we had examined the earnings releases for a random sample of 200 and 123 companies from the S&P 500, in 2022 and 2021, respectively.

We also expanded this year's research by including non-GAAP adjustments by industry. We looked at the industries with most significant adjustments as well as the most notable categories of adjustments for each industry. This separate industry report is available on request.

Key Findings

- Average adjusted (that is, non-GAAP) Net Income was almost $3.1B, lower than last year's non-GAAP Net Income of almost $4B. This is consistent with a decrease we saw in GAAP Net Income.
- Adjusted Net Income exceeded GAAP Net Income by an average **$698M** per company, or about **29%** of GAAP Net Income, which implies a corresponding increase in EPS.
- This average 29% adjustment is a decline from last year, when we found adjusted Net Income exceeded GAAP Net Income by an average of $1.095B per company, or about 38% of GAAP Net Income.
- We found a total of **1,649** individual reconciling items for our sample, with a total value of almost **$182B** and an average value of **$110M** per item (a decrease of 40% from last year).
- Although the adjusted amounts were smaller than last year, the average number of adjustments ticked upward. Companies had an average of **6.3** reconciling items per company in 2023, compared to an average of 5.9 adjustments the prior year.
- The types of non-GAAP adjustments also held relatively steady, as shown in the distribution of adjustment frequency by category later in this report.
- The category of adjustments with the highest dollar value was Amortization of Intangibles, at almost 33% of total adjusted amount. Next were Impairments, which accounted for about 23% of total adjustments.[1]

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[1] See the 2023 Reconciliations Table for more details.

- Last year the category of adjustments with the highest value was Impairments followed by Amortization of Intangibles. This was likely caused by two large impairments that totaled more than $41B, which pushed up the total value of impairment adjustments last year considerably.
- Our sample this year includes some noteworthy adjustments.
    - 3M Corp. (MMM) included a litigation adjustment of $11.6B.[2]
    - Bristol Myers Squibb (BMY) reported an adjustment $9B for the amortization of acquired intangible assets.
    - Walgreens Boots Alliance (WBA) included a $7.5B adjustment for "Certain legal and regulatory accruals and settlements".[3]
    - Marriott International (MAR) reported two large adjustments. First the company deducted cost reimbursement revenue of $17.4B, and then it added reimbursed expenses of $17.4B. Last year these adjustments were $15.4B and $15.1B, respectively.[4]
- The five companies with the largest adjustments by dollar volume account for almost 29% of total amount adjusted. That is down from last year, when the top five accounted for 37% of total amount adjusted.

Overall, our findings continue to question the informative value of as-reported GAAP Net Income (since so many companies report substantially different adjusted Net Income numbers) and raise questions about whether changes might be necessary to the calculation of GAAP Net Income.

[2] 3M reported in their earnings release on 1/23/2024 this adjustment as "Net costs for significant litigation".

[3] On 10/12/2023, the company reported in their earnings release: "Certain legal and regulatory accruals and settlements relate to significant charges associated with certain legal proceedings, including legal defense costs. The Company excludes these charges when evaluating operating performance because it does not incur such charges on a predictable basis and exclusion of such charges enables more consistent evaluation of the Company's operating performance. These charges are recorded within Selling, general and administrative expenses within the Consolidated Statement of Earnings. In fiscal 2023, the Company recorded charges related to the opioid litigation settlement frameworks and certain other legal matters. In fiscal 2022, the Company recorded charges related to a settlement agreement with the State of Florida to resolve all claims related to the distribution and dispensing of prescription opioid medications across the Company's pharmacies in the State of Florida."

[4] Marriot said in their earning press release filed 2/13/2024: "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." This is the exact same explanation given last year.

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)
2023	260	$64,741 (12/31/2023)	$2,412	$698 (29%)	$3,111
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

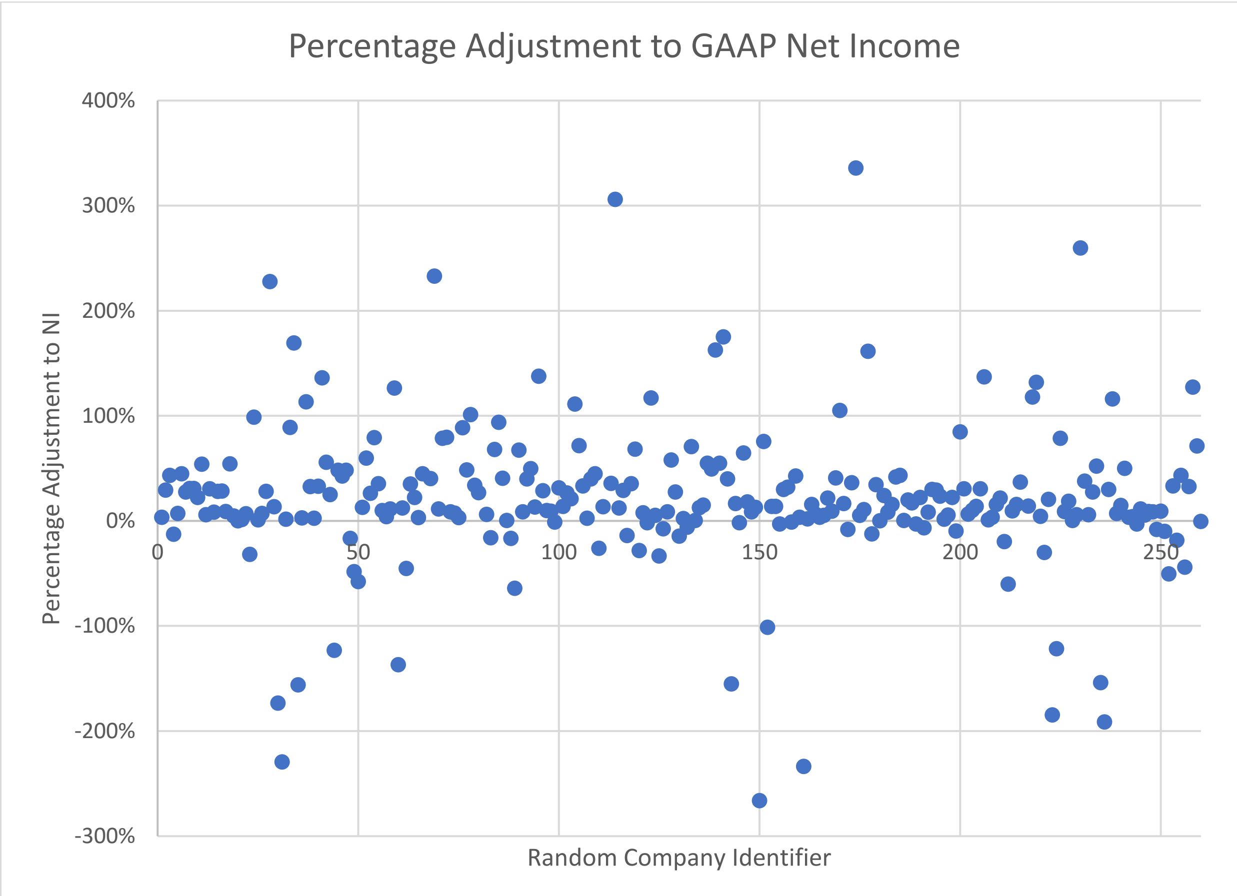
- The average size of companies examined was about $64B (based on end-of-year market cap), similar to last year.
- In our 2023 sample of random firms, non-GAAP Net Income exceeded GAAP Net Income by about 29%.
- In comparison, for our 2022 sample of random firms, non-GAAP Net Income exceeded GAAP Net Income by about 38%. This can be further compared to our 2021 sample of random firms, when non-GAAP net income exceeded GAAP Net Income by about 14%.
- Interestingly, average non-GAAP Net Income in 2023 declined from 2022 levels by about 27%, which is larger than the decrease in average GAAP Net Income, which decreased by about 19% from 2022.

Adjustments Analysis

We examined the reconciliation between GAAP and non-GAAP Net Income and studied the different reconciling items companies used. The reconciling items were classified into 10 categories to study how common the different categories are across firms.

- The average individual adjustment to GAAP Net Income was almost $110M, considerably lower than last year's average of $184M. In 2021, the average individual adjustment was about $120M.
- The average number of adjustments per company remained roughly the same:
  - 6.3 adjustments per company in 2023
  - 5.9 adjustments per company in 2022
  - 5.8 adjustments per company in 2021
- 86% of companies adjusted non-GAAP income upwards (meaning non-GAAP Net Income was higher than GAAP income), while 14% of companies adjusted their non-GAAP income downward. This is relatively consistent with last year, which saw 83% of companies adjusted non-GAAP income upwards and 17% adjusted downward.

- The scatterplot below shows the range of adjustments as a percentage of GAAP Net Income. About two-thirds of companies show adjustments of up to 50%. Another 18% show (positive) adjustments of more than 50% to GAAP net income, and about 8% adjusted GAAP Net Income upwards more than 100%.[5]

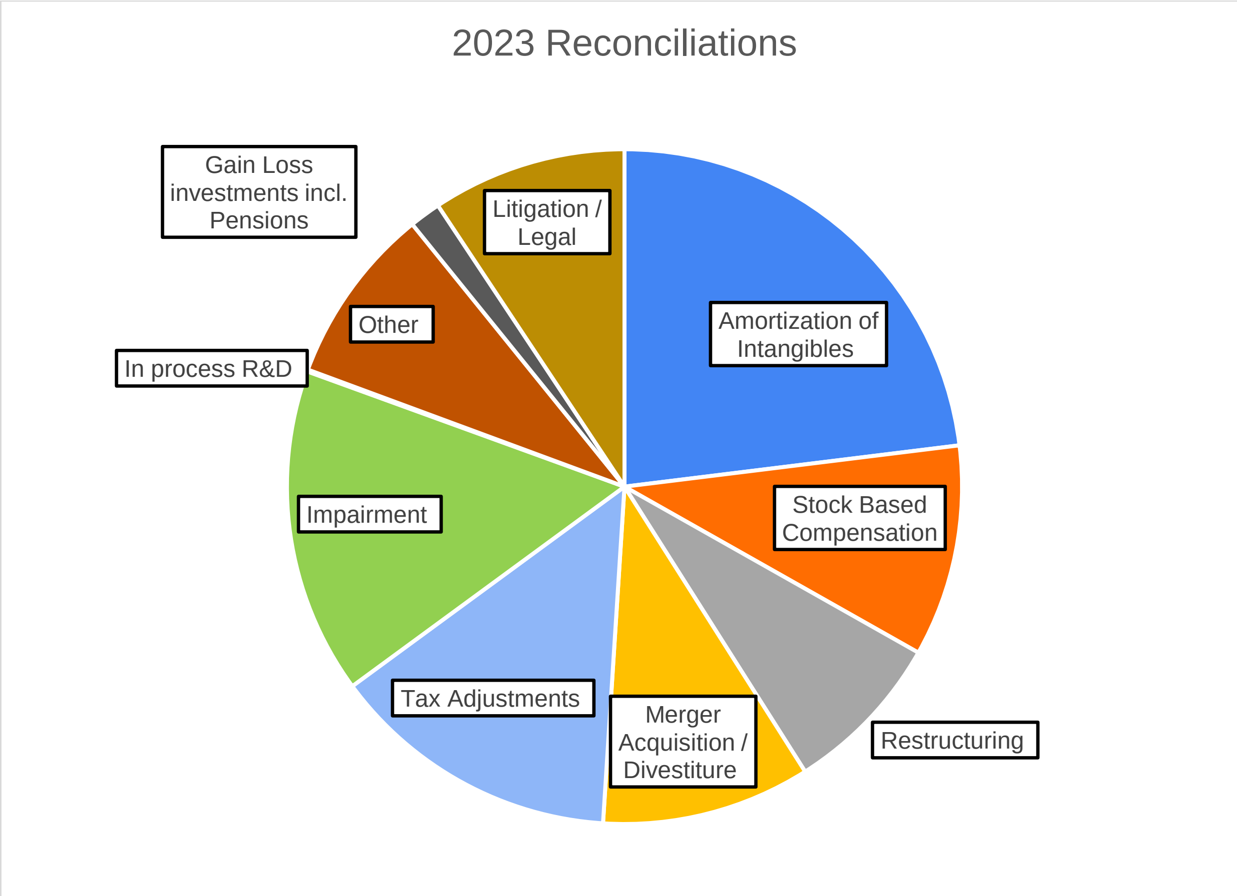


The charts below show the adjustments to GAAP Net Income by category for the last three years.

- Amortization of intangibles constitutes the largest category accounting for about one-third of total amount adjusted, compared to one-fourth in last year's sample.
- Impairments is now the second-largest category of adjustments, accounting for about a fourth of total amount adjusted. Last year impairments were the largest category, accounting for one-third of total amount adjusted). This change compared to last year is

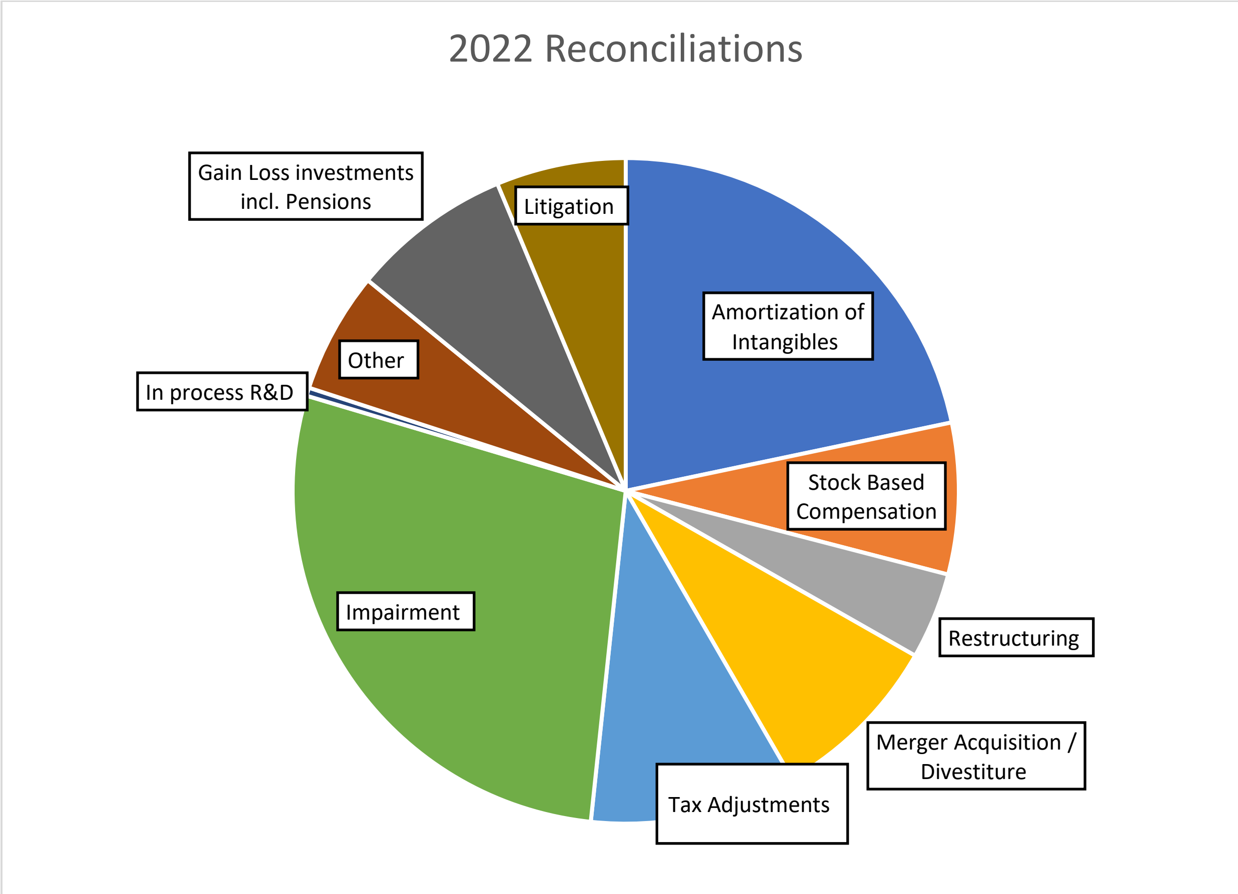
[5] Four companies in our sample are outside the range shown in the scatterplot. Aes Corp. (AES) had a decrease of 665% to GAAP Net Income, Eversource Energy (ES) had a decrease of 449% to GAAP Net Income, DENTSPLY SIRONA Inc. (XRAY) had a decrease of 395% to GAAP Net Income, and Invesco Ltd. (IVZ) had a decrease of 307% to GAAP Net Income.

likely a result of two large impairment adjustments (totaling more than $41B) in 2022 from AT&T (T) and Fidelity National Information Services (FIS).



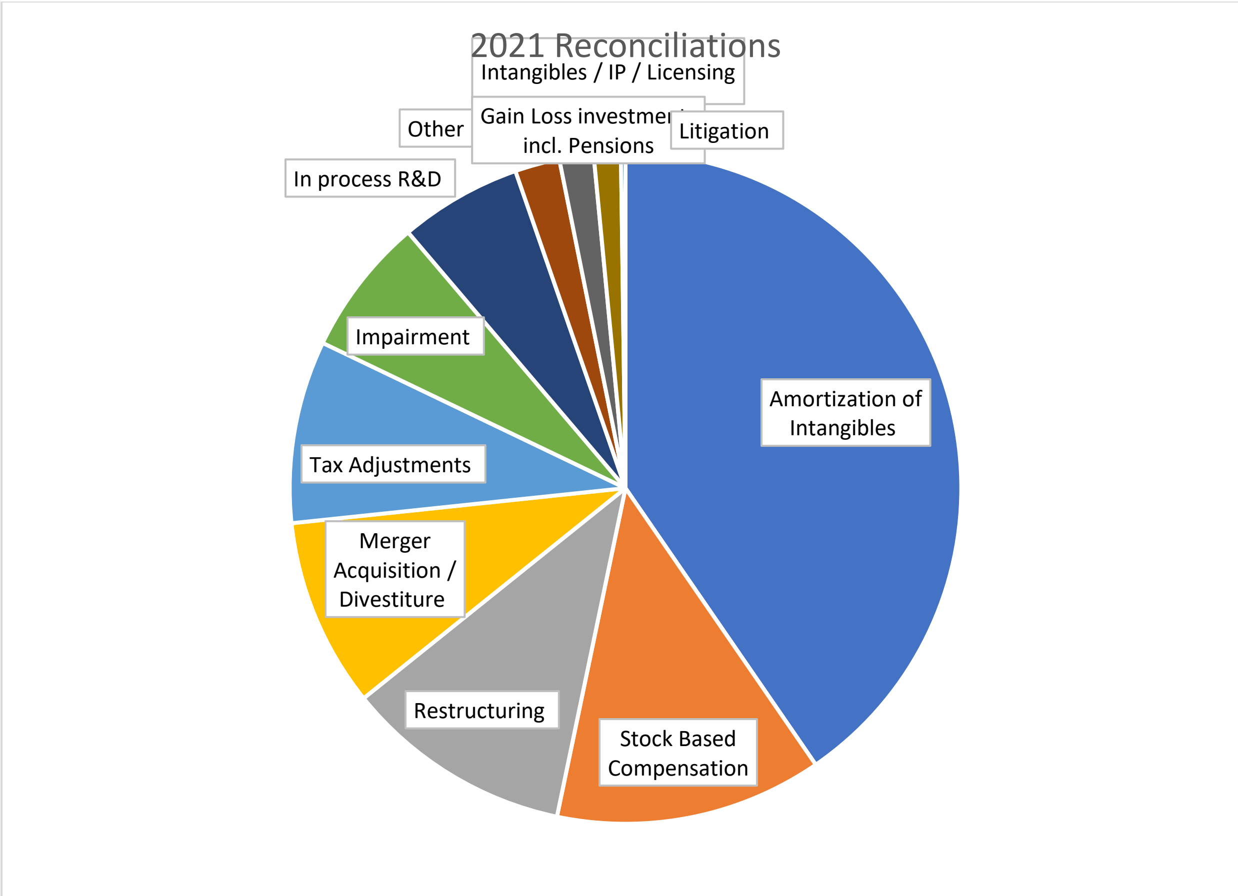
2023 reconciliations

Category	Adjustment Count	Dollars Adjusted (in millions USD)	Percent of Total	Average Adjustment (in millions USD)
Amortization of Intangibles	147	60,474	33.32%	411
Stock Based Compensation	73	26,615	14.66%	365
Restructuring	192	20,529	11.31%	107
Merger Acquisition / Divestiture	226	26,246	14.46%	116
Tax Adjustments	280	(36,509)	-20.11%	(130)
Impairment	100	40,990	22.58%	410
In process R&D	3	233	0.13%	78
Other	248	22,416	12.35%	90
Gain Loss investments incl. Pensions	294	(3,938)	-2.17%	(13)
Litigation	86	24,459	13.47%	284
Total	**1649**	**181,512**	**100.00%**	**110**



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**



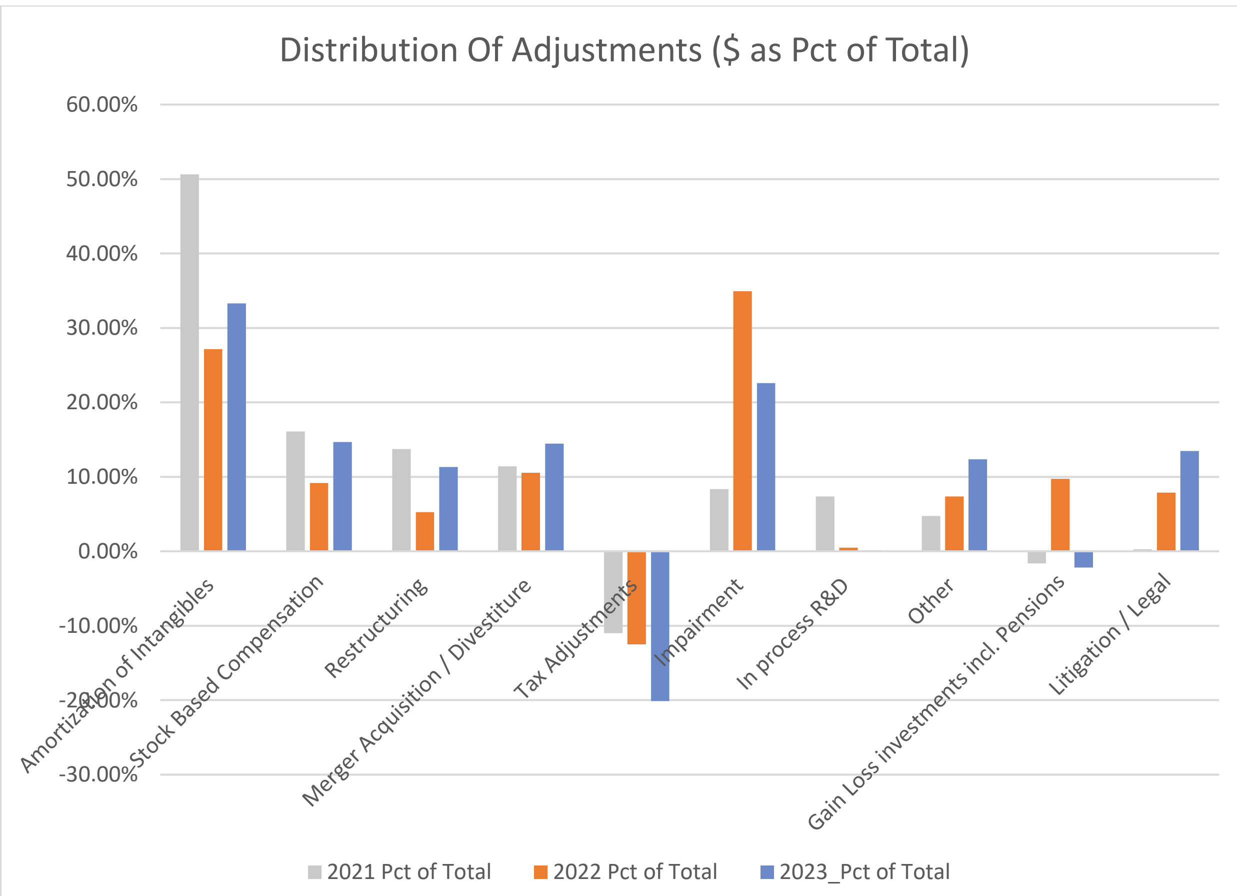
2021 reconciliations

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**

Distribution of Adjustment Categories

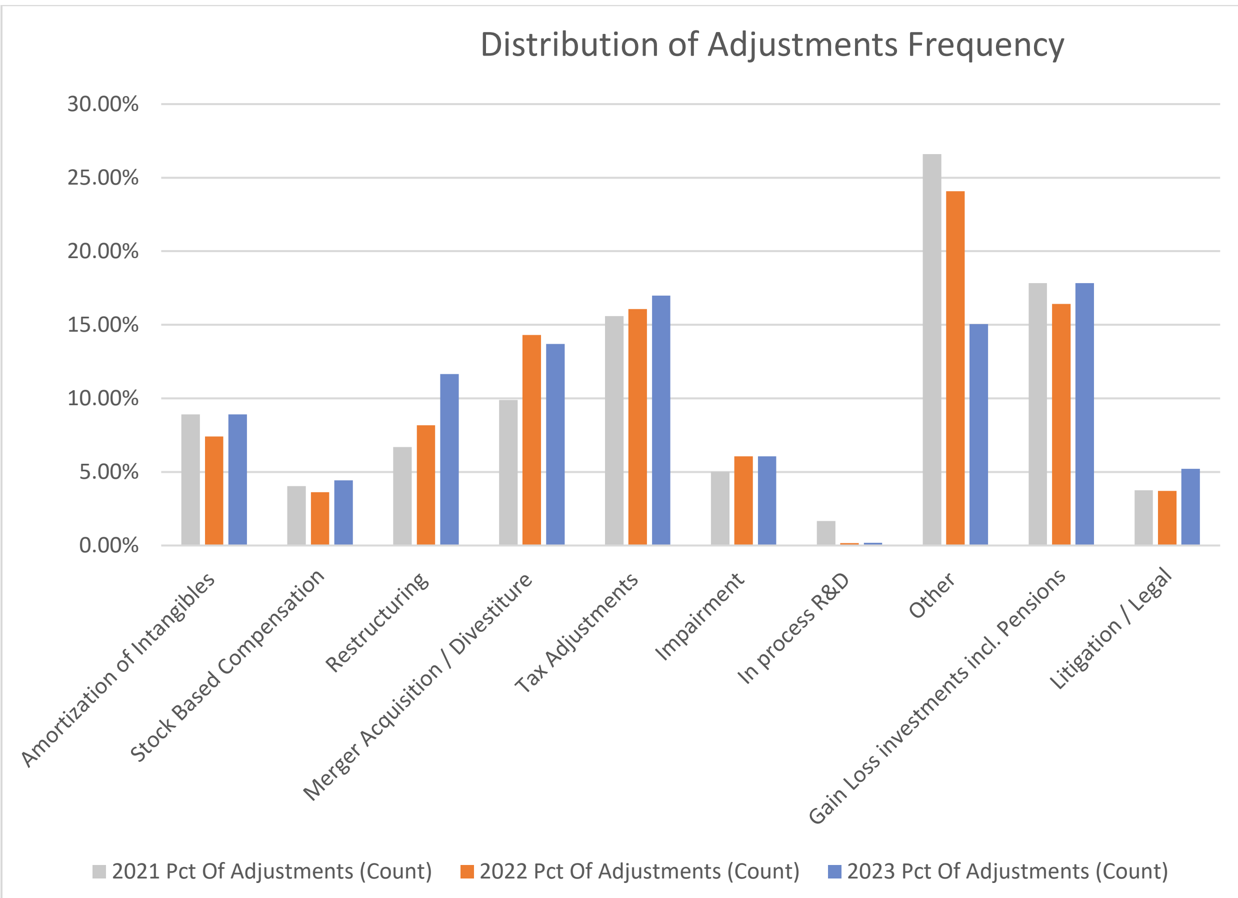
We compared the distribution of the adjustment categories for the last three years. Our comparison is based both on the number of adjustments for each category, as well as on the total amount adjusted for each category.

- The Gain/Loss on Investments adjustments were negative in total for 2021 and 2023, but positive for 2022. With the equity markets performing better in 2021 and 2023 compared with 2022, this finding is consistent with companies, on average, adding back losses in 2022, and subtracting gains in 2021 and 2023.
- Similarly, we observed fewer impairments in years where the equity markets perform better (2021 and 2023) than in years they do not perform as well (2022).[6]
- We also observed a significant decrease in the amount of amortization being adjusted, from about 50% of total adjustment dollars in 2021 to about 30% in 2022 and 2023. This remains an area for additional research.



[6] As reported before, in 2022 we reported two very large impairment adjustments. These account for only a portion of the decrease we observe in the category from 2022 to 2023.

- The distribution of the number of adjustments by category seems to be relatively stable over the last three years. The decrease in the “other” category is somewhat by design, as we tried to categorize fewer adjustments as “other” in favor of a suitable close category.
- This stable distribution of adjustments suggests that companies might have a template they follow, or have a list of adjustments they typically make to adjust GAAP Net Income.



What does it all mean?

The vast majority of companies in our sample (86%) adjust 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.

The 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.

- The majority of companies in our sample (134 firms, or almost 52%) included that adjustment in their calculation of non-GAAP Net Income, and these adjustments accounted for one-third of all adjustments (by amount adjusted).
- 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 new Net Income number 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? Should this change only apply to certain industries, such as pharmaceuticals?

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 to separate transitory and permanent items.

- Some of the adjustment categories are more likely to be transitory, such as Impairments, Restructuring, Merger& Acquisition, or Divestiture. This would suggest that adjusting for those items may eliminate more transitory items from reported earnings.
- Other 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 2024, led by Associate Dean Tracey Riley and Professor Regina O'Neil. Students participating in the report include: Alexis Aubin, Anem Haider, Daniela Betancur, Elianna Rodriguez, Gyselle Campos, Jack Branson, Jacob Dubin, Julani Perez, Kamila Lopes Cula Cardoso, Melinda Ngo, Michael Graham, Nicolas Nese, Sarah Phan, Trinh Le, and Yamil Muñoz Valdez.