CTC Investor Relations

Market News

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A monthly review of IR developments for our clients and friends. . .

Do non-GAAP financials lead to low-ball Street estimates?

General Accepted Accounting Principles (GAAP) have been increasingly overshadowed by alternative non-GAAP metrics, known as *Street* earnings. Ninety percent of S&P 500 companies reported at least one non-GAAP measure in 2017. The alternative financials are meant to give investors a clearer picture of operating results. But a study of 4,700 companies' quarterly reports over the past 17 years revealed a different picture. The number of large (5 to 15 cents) favorable surprises in reported non-GAAP results vs. non-GAAP Street earnings estimates doubled to 25.5 percent of "beats" over the period. The number of small (a penny to two cents) favorable surprises in non-GAAP earnings dropped about 15 percent. In contrast, earnings surprises as measured by reported GAAP earnings vs. analysts' GAAP estimates were stable over the 17 years.

Scrapping quarterly reporting? Not everyone thinks it's a good idea

We know who likes it: President Trump and virtually every CFO in America. And we know who doesn't: Most investors and many accounting professors like Paul B.W. Miller and Paul R. Bahnson, who called it "a long-dead idea that should have remained in the grave." What does the data show? An *Accounting Review* analysis looked at patterns before and after past reporting-frequency changes in 1955, 1962 and 1970. It found evidence of "managerial myopia" after reporting became more frequent: smaller capital investments and lower operating efficiency and sales growth. Reduced capex was greatest in heavy manufacturing, where investments take time to generate higher earnings. The study acknowledged that increased reporting frequency has pluses, such as lower cost of capital and better investor decisions.

Board diversity hits a milestone

A group of 72 U.S. public companies that committed in 2014 to have women comprise at least 30 percent of their board announced they have exceeded their goal. In 2014, 21 percent of their board members were female. The 30 Percent Club was the original idea of a group of British companies in 2010 that has since established 11 chapters worldwide, including the U.S. chapter started by Bloomberg's chairman, Peter Grauer. The movement is impacting Fortune 500 companies, whose boards include 22.2 percent women, up almost 4 percent from 2014, according to Heidrick & Struggles. The study notes that boards no longer insist on sitting and former CEOs; they now look at candidates' skillsets.

Equity markets shrink as buybacks reach new high

S&P 500 companies repurchased $166.3 billion worth of shares during the first quarter, up 18.7 percent from a year ago. This number has experts predicting buybacks in the US will hit a trillion dollars in 2018. Overall volume of companies going public, issuing new stock or selling convertible debt is being overwhelmed by the number of repurchased shares. As a result the equity market is shrinking at its fastest pace in two decades; experts see the trend continuing into 2019.

Glut of whistleblowers gumming up the system

Today it take the average whistleblower two years to have a tip investigated and the reward delivered if so deserving. That is double of what it was when the program started seven years ago. Over those years more than $266 million has been distributed to 55 tipsters, including an $82 million award given in March to three tipsters who told regulators about a complex scheme at Bank of America. The SEC says one reason for the backlog is the publicity that such large rewards receive. They also point a finger at frivolous reward seekers who file hundreds to tips. Regulators are working to correct the problem, finding ways to remove red tape and the flood of undeserving tipsters in fear that the current situation is jeopardizing the program.

Stocks are up and top executives are on the move

CEOs, financial chiefs and chief operating officers are on track to reach a 24-year high turnover rate in 2018 with 18 percent of the professionals leaving for other jobs. This is according to a study conducted by recruiting firm Crist Kolder. The annual Volatility Report surveys 673 companies that are either in the *Fortune 500* or *S&P 500*. It's not a surprising trend. Traditionally, when stock prices climb, executives become likelier to cash in equity awards and make job or life changes.

Accelerated share repurchases may help management more than shareholders

An increasingly popular form of buyback — accelerated share repurchases, or ASRs — may not be as shareholder-friendly as some issuers claim. Ahmet Kurt, assistant professor of accounting at Suffolk University in Boston, says data shows that 29 percent of the ASRs completed in his study period boosted reported EPS above consensus for the period after the ASR. Under an ASR, an investment bank borrows large blocks of shares from institutional investors to sell to the issuer at market, and replaces them over time through its own open market purchases. The immediate reduction in shares outstanding means a quick boost in EPS. Kurt's analysis of 293 ASR transactions during the 2004-2011 period found most preceded improved operating performance. Kurt says the "EPS-suspect" issuers who beat consensus thanks to an ASR tended to be issuers that provided their CEOs with EPS-linked bonus payments and those that consistently beat EPS targets for the past three years

Microcap boards smaller, less independent and less diverse

Corporate governance at micro-capitalization (<$300M) companies is a lot different than at bigger public companies. Board Governance Research looked at governance practices at 160 microcaps traded on a major U.S. stock exchange, representing approximately ten percent of all such companies. Key findings were that microcaps usually aren't young and do not have multi-class stock. Only four percent have one shareholder controlling more than 50 percent of the stock. Microcap boards are less independent. In most cases independent directors make up less than 80 percent of the board. CEOs of microcaps are just as likely to chair the board as at larger companies, but fewer have a named lead director. Sixty-one percent of microcaps have no female directors, versus 21 percent of large-caps. Microcap boards are smaller. The average microcap board has 6.9 directors, compared to 8.9 at larger companies. Nearly a quarter (22 percent) of microcaps have boards with five or fewer directors.

The Tesla Tweets: "Why, Elon, Why?"

Along with the class action suits already filed and the SEC investigation underway, many investors are simply wondering: Why did Elon Musk do something so stupid as propose a Tesla buyout in a random tweet? And most of all, why did he add the kicker, "funding secured" when it wasn't? Musk's simple answer is that Saudi investors have been urging him to do it for two years, and offered their help. But Musk apparently did not have a secured financial commitment for a specific transaction. Analysts expect the litigation and SEC penalties to be very costly for both Musk and Tesla.

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