

INVESTOR RELATIONS AND ACCOUNTING'S RELEVANCE LOST

By

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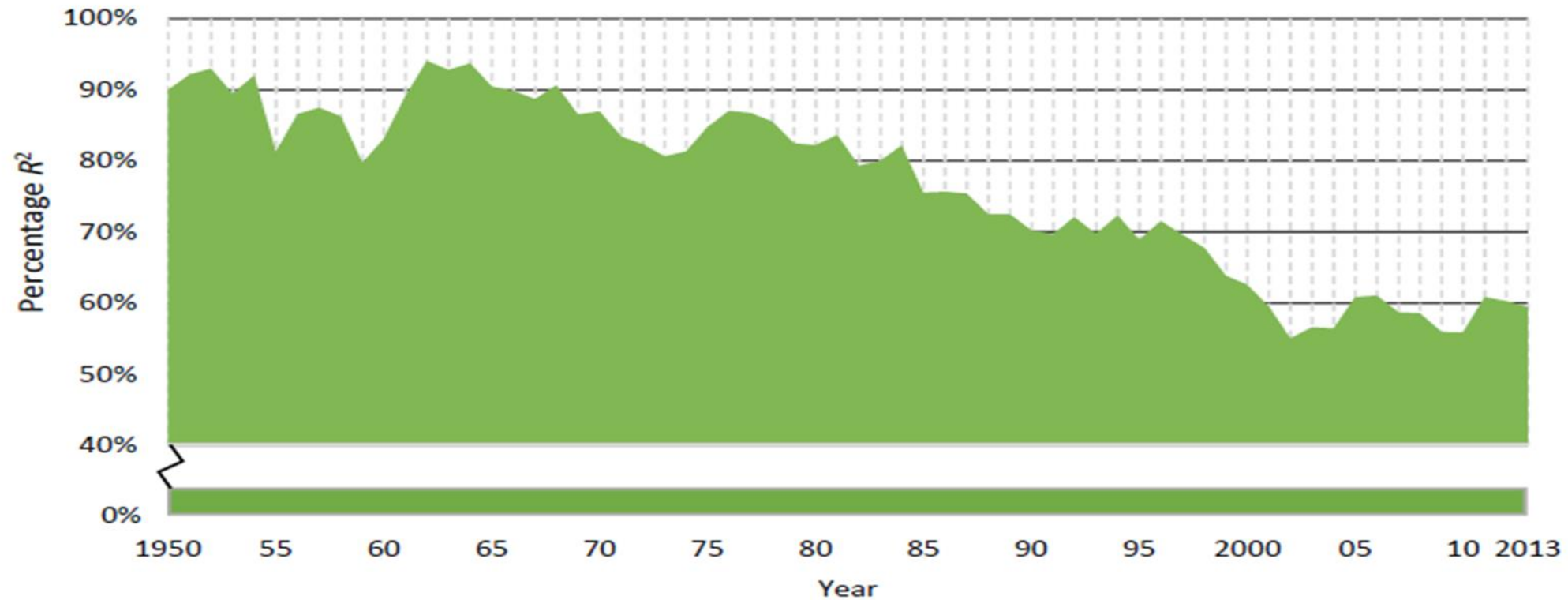
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Blog: Lev End of Accounting

Disclosing and Clarifying Financial Information Is a Major Activity of IROs, But...

Figure 3.4: Decreasing Share of Corporate Market Value Attributed to Multiple Financial Indicators

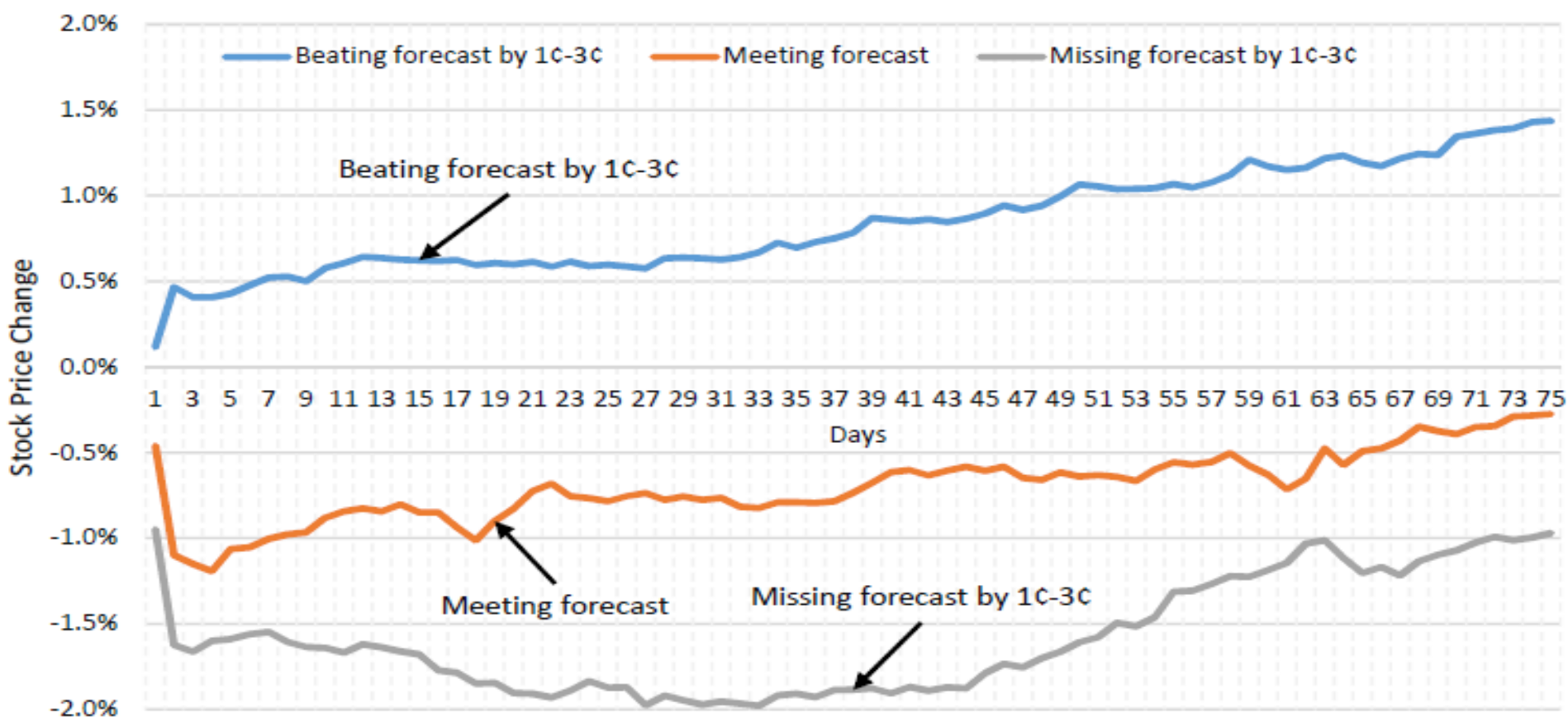
Adjusted R^2 from regression of companies' market value on their sales, cost of sales, SG&A, earnings, assets, and liabilities, 1950-2013



From: Lev and Gu, "The End of Accounting and the Path Forward for Investors and Managers," 2016.

But What About “Earnings Moving Markets”? No Longer

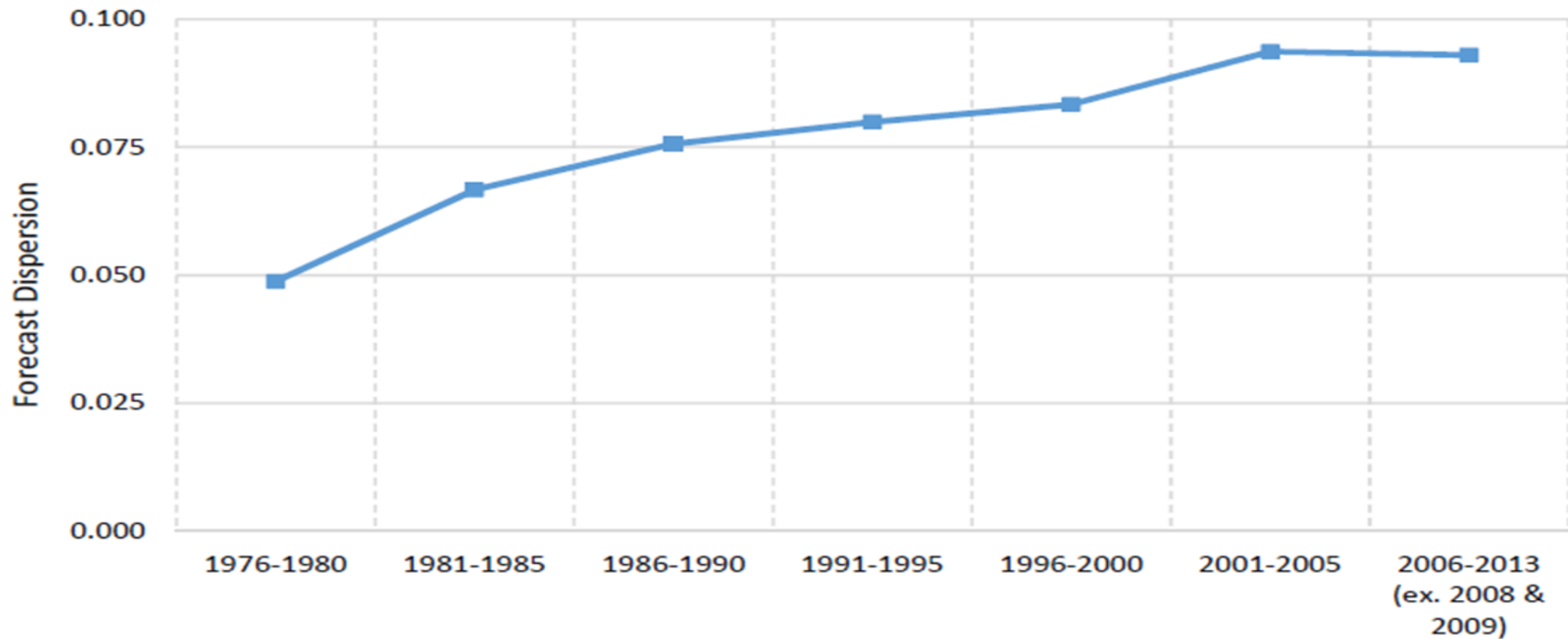
Figure 2.3: The Consequences of Missing or Beating the Consensus Earnings Estimate
75-day average stock price changes (returns) from the earnings announcement for companies that missed the consensus EPS or beat the consensus by 1-3 cents, 2011-2013



That's Not Just An "Accountants' Issue": Investors' Uncertainty On The Rise

Figure 6.1: Analysts' Ambiguity on the Rise

Five-year median analysts' dispersion (standard deviation) around the consensus estimate, 1976-2013 (2008 and 2009 omitted)

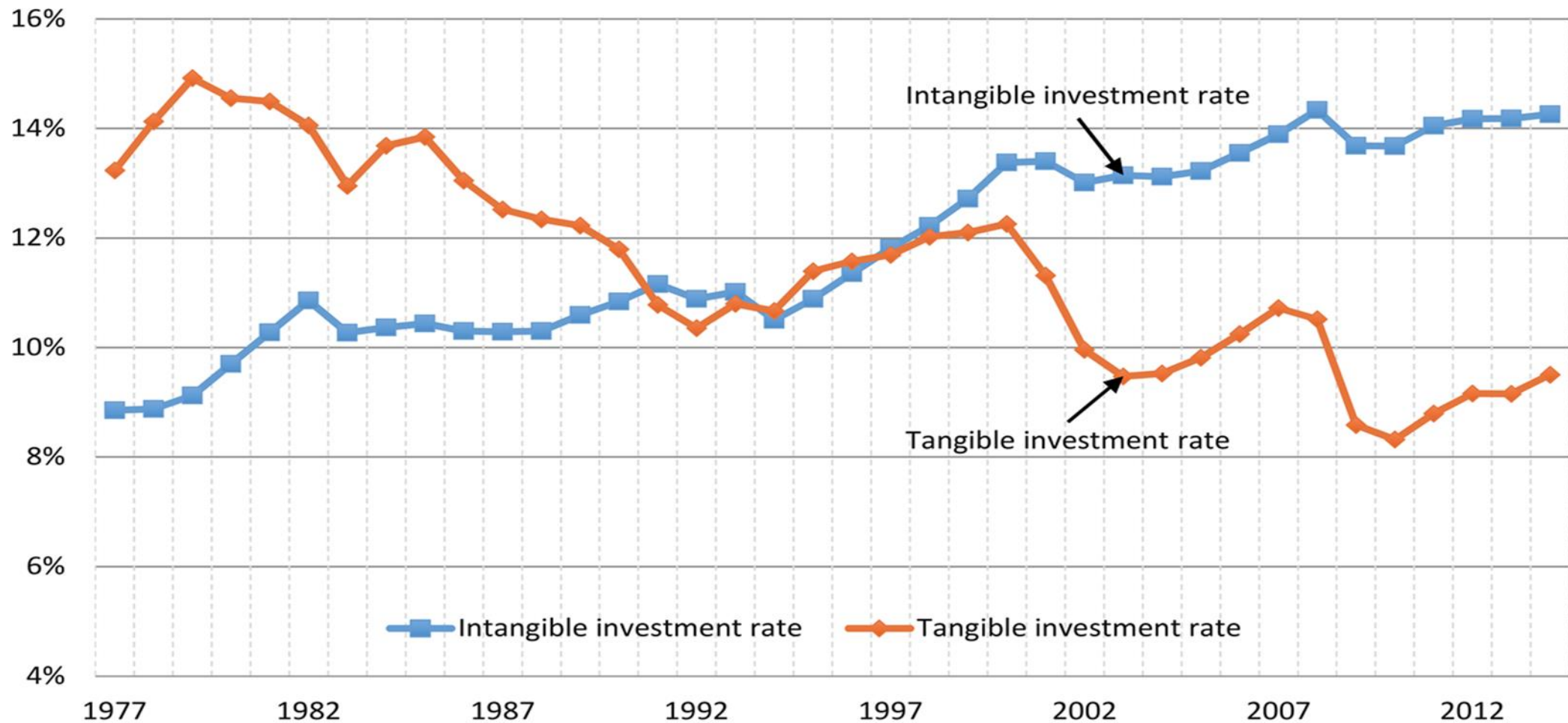


From: Lev and Gu, "The End of Accounting and the Path Forward for Investors and Managers," 2016.

Reason 1: Dramatic Change In Companies' Business Models, While Accountants Asleep At The Wheel

Figure 8.1: The Intangibles Revolution

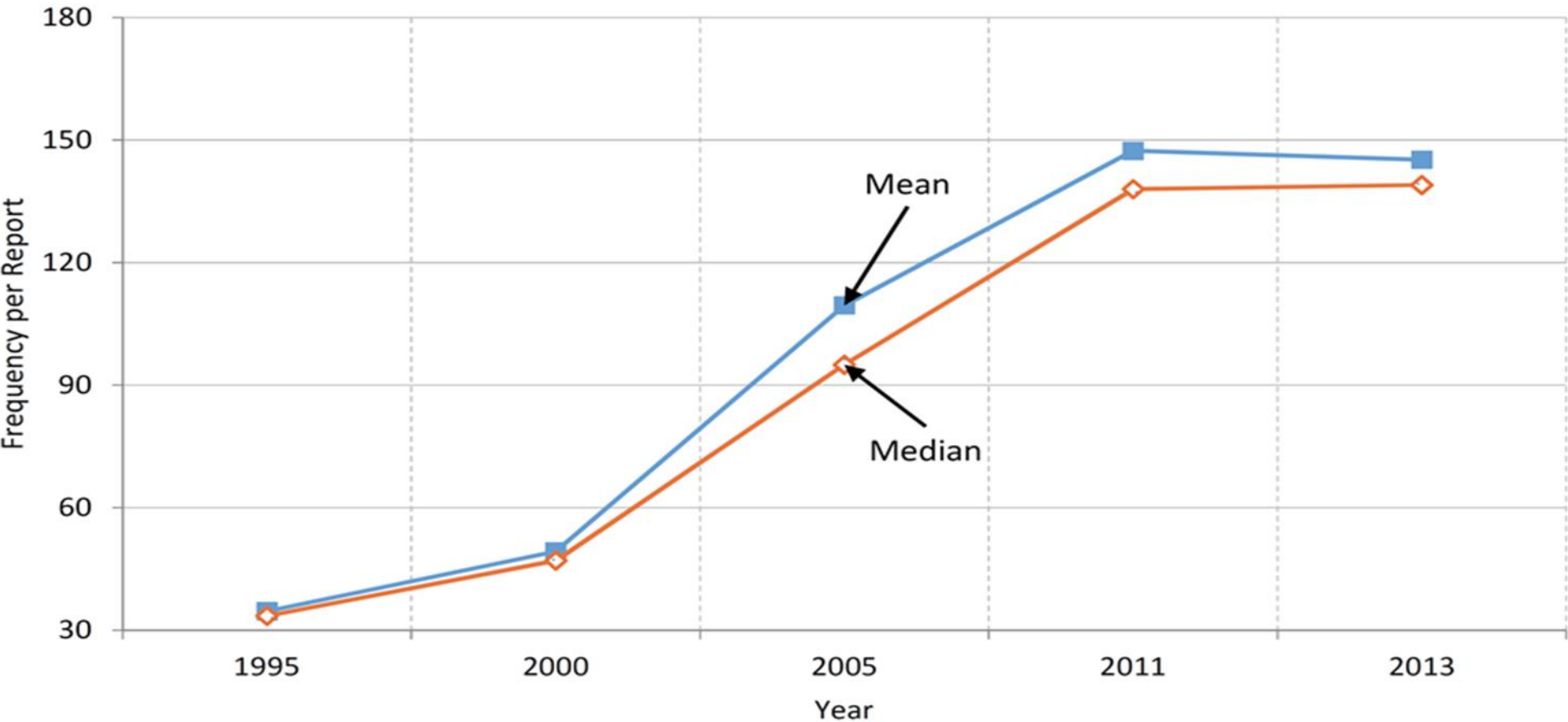
US private sector investment in tangible and intangible capital (relative to gross value added), 1977-2014



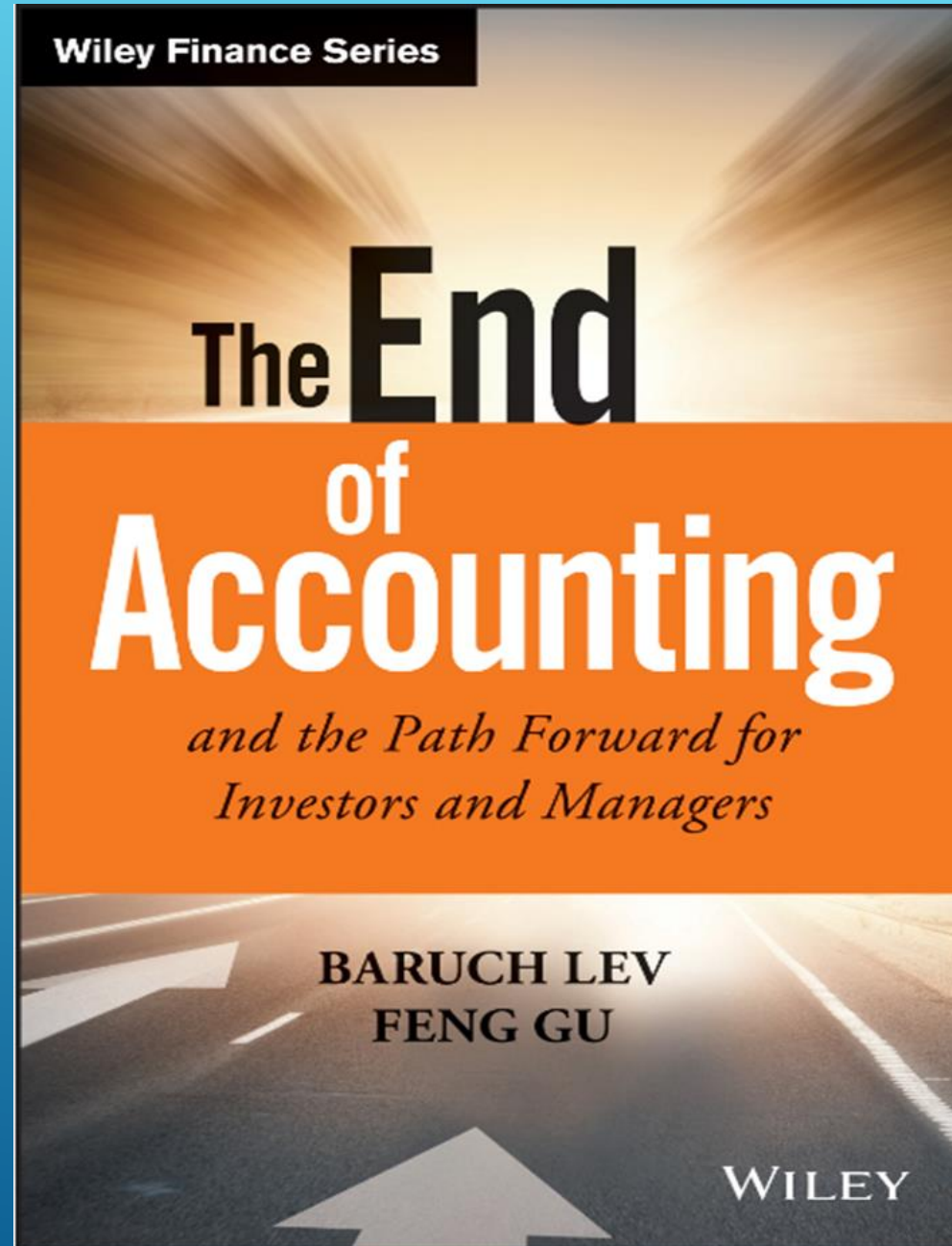
Reason 2: Accounting Isn't About Facts Anymore: Multiple Managerial Estimates, Projections, Guesses, and Occasional Manipulations Underlying Financial Information Decrease Information Reliability (Relevance)

Figure 9.1: Increasing Frequency of Estimates-related Terms in Financial Reports

For a sample of 50 S&P 500 companies



Not for nothing did I call the book: *The End of Accounting*



So What's An IRO To Do?

Disseminate And Discuss Relevant Information

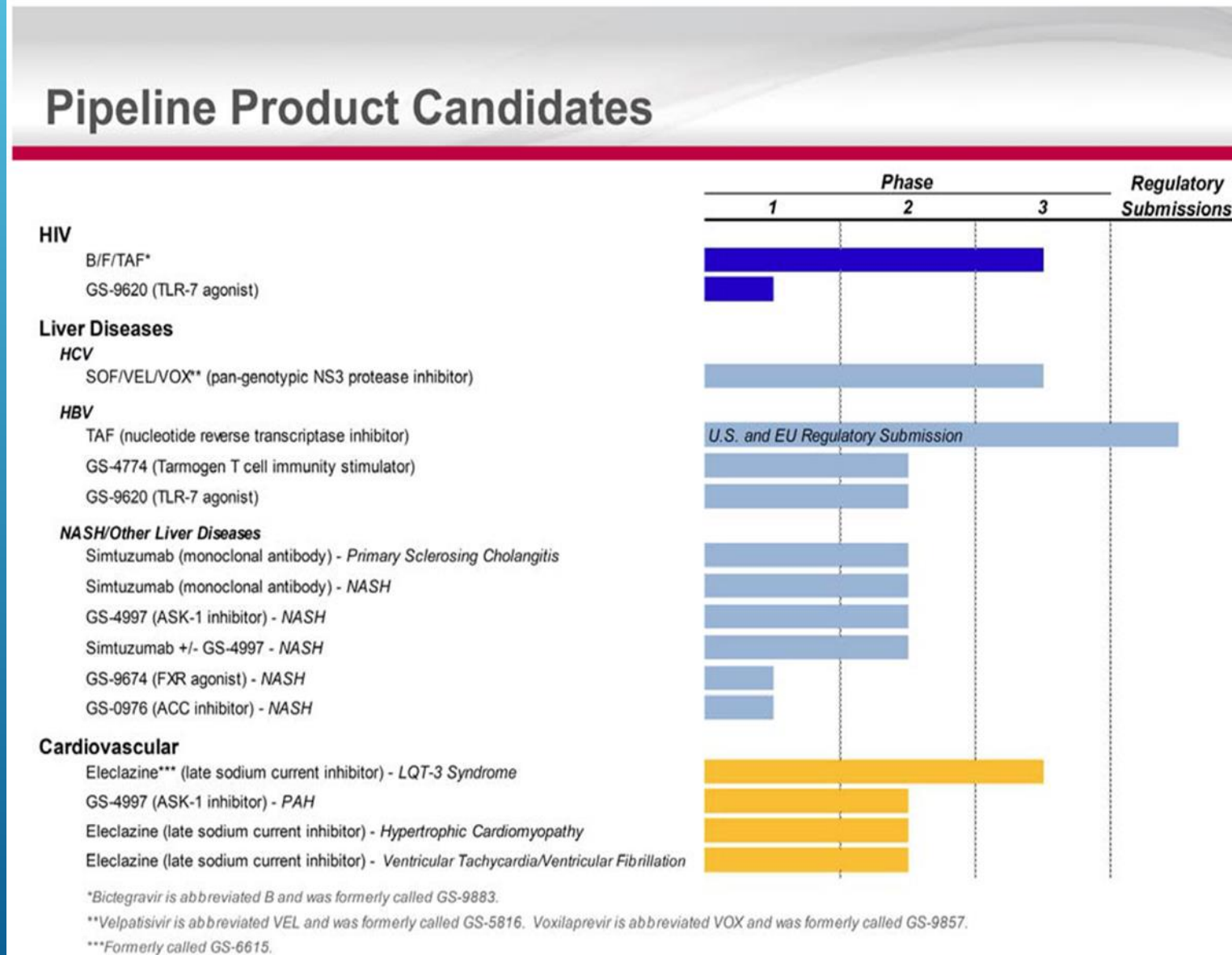
- ❖ Enterprise objective: Gaining Sustained Competitive Advantage (Long-Term)
- ❖ How? By having and successfully deploying “strategic assets”
- ❖ Strategic assets are:
 - Generating benefits (customer franchise, licensed patents)
 - Rare; limited supply (wireless spectrum, airline landing rights)
 - Difficult to imitate (brands, oil & gas properties)

That's Exactly What Analysts Asked In Hundreds of Earnings Calls In Other Industries

Q3 2016			Q2 2016		
→	1	Capital spending guidance	1		Capital spending guidance
↑	2	Portfolio optimization	2		Production outlook
↓	3	Production outlook	3		Portfolio optimization
↑	4	Major projects	4		Cash flow targets
↑	5	Cost reduction	5		Major projects
↑	6	Shareholder distributions	6		Refining margins
new	7	Working capital	7		Cost reduction
↓	8	Cash flow targets	8		Shareholder distributions
new	9	Price realizations	9		LNG market developments
↓	10	LNG market developments	10		Tax trends

Strategic Asset: Example

Figure 3: Product Pipeline (Partial) of Gilead Sciences, Q2 2016



Strategic Asset: Example

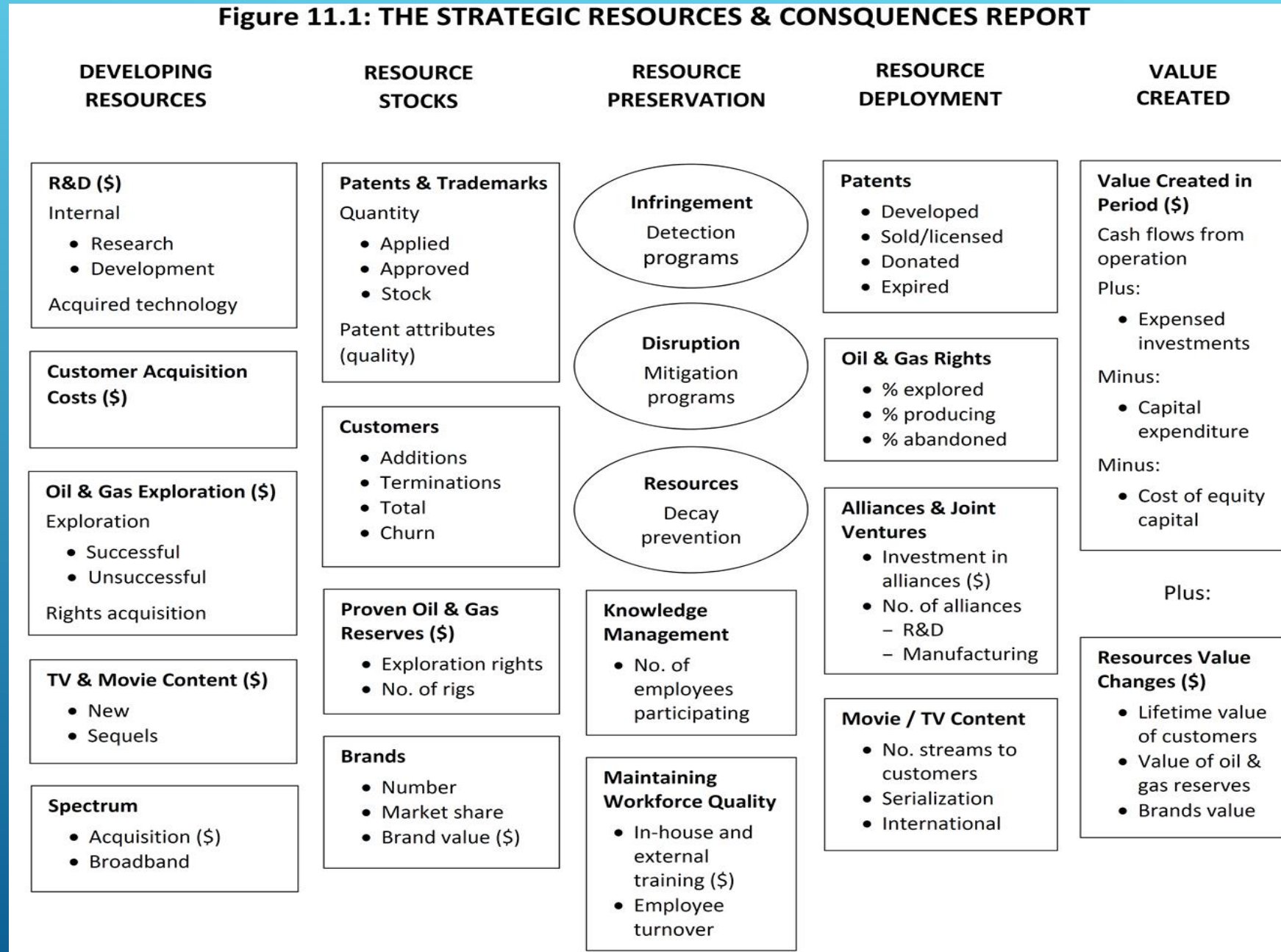
SIRIUS XM

Subscriber Franchise

	<u>Q3 – 2016</u>	<u>Q2 – 2016</u>
<u>Net Edditions (thousands):</u>		
Self-pay	385	507
Paid promotional	-39	80
Total	346	587
<u>Ending Subscribers (thousands)</u>		
Self-pay	25,528	25,143
Paid promotional	5,463	5,503
Total	30,991	30,646
<u>Churn Rate</u>	1.9%	1.6%
<u>Conversion: New Vehicles</u>	40%	40%
<u>New Car Penetration</u>	75%	78%
<u>All Car Penetration</u>	33%	33%
<u>Subscriber Acquisition Costs (\$000)</u>	120,111	128,956

Major Themes To Be Discussed With Investors

Figure 11.1: THE STRATEGIC RESOURCES & CONSEQUENCES REPORT



Takeaway

- ❖ GAAP-based financial information largely outlived its usefulness for investors (and managers)
- ❖ Patching the information—Non-GAAP Earnings — improves relevance marginally
- ❖ Relevant, transparency-increasing information revolves around the business model, value-driving strategic assets, and real value creation.