



*December 2017*

# Market News

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

## **Survey finds that money managers devoted to non-GAAP measures**

Perhaps it shouldn't be surprising amid the battles over fake vs. real news, but a recent study makes it clear that investment professionals are growing increasingly attached to non-GAAP over GAAP results as their principal yardsticks for valuing and comparing companies. The study by Chicago's Clermont Partners was inspired by 2016's *The End of Accounting*, in which professors Baruch Lev and Feng Gu made a persuasive case for new accounting standards that blend the best of GAAP and non-GAAP measures. Clermont's follow-on survey found that 74 percent of the money managers it surveyed admitted that they already rely heavily on non-GAAP numbers, including some they create themselves, in making investment decisions. Many respondents were eager to explain their views, adding comments such as "GAAP means nothing to me" and "GAAP is rarely comparable and doesn't show the underlying trends in the business."

## **New proxy guidance for 2018 suggests tougher S&P500 standards**

Advisory firms Institutional Shareholder Services and Glass Lewis have issued preliminary guidance for their vote recommendations on compensation and other matters in 2018 proxy ballots. ISS's guidance updates its pay-for-performance methodology and its U.S. Equity Plan Scorecard (EPSC) evaluation as applied to stock plan proposals in ways that raise its standards slightly for pay performance for S&P 500 companies, but it also adopted new smoothing techniques for measuring total shareholder return for 2018. Glass Lewis is again calling for more female directors, a tougher stance on virtual-only shareholder meetings, and is clarifying its stance on board responsiveness and dual-class share structures, among other topics.

## **FASB aligning its materiality definition with SEC and PCAOB**

The Financial Accounting Standards Board has opted to throw in the towel on its proposed new materiality disclosure standard, opting instead to revert to a prior one favored by fellow financial regulators at the SEC and Public Company Accounting Oversight Board, as well as by the accounting profession. The FASB had wanted to adopt the Supreme Court's definition that refers to information that, if omitted, would cause "a reasonable resource provider" to regard the "total mix of information" as changed. That's the one business groups prefer, but most investors dislike. The FASB now backs the version that defines materiality in the context of "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person" would change.

## **Short sellers attracting regulatory attention as activist campaigns grow**

A rising proportion of short-selling activity is coming from activist campaigns, a trend that is attracting the SEC's attention. Activist Insight says that there were short campaigns against 224 companies globally last year, versus 130 in 2013. Regulators say such efforts can evolve into cases of illegal market manipulation. Even routine short-selling is up this year, as hedge funds position for the possible end to a bull run in technology stocks. Activists have also been expanding campaigns in Japan, Hong Kong and Singapore. In 2017, Hong Kong-listed China Huishan Dairy Holdings Co. plunged 85 percent in a single day and prepared for provisional liquidation, less than a year after a report by short seller Muddy Waters.

### **Congress moving toward new definition of accredited investor**

The U.S. House of Representatives last month approved the Fair Investment Opportunities for Professional Experts Act, which among other things revises the definition of “accredited investor” to include those with strong financial backgrounds that might not qualify under the traditional asset/income tests. The new minimum requirements include net worth with spouse above \$1 million, excluding the primary residence; individuals with income of at least \$200,000, or joint spousal income more than \$300,000; one who has a state-issued financial services license; and those that the SEC determines to be sufficiently experienced. The bill has passed to the U.S. Senate, which is in no rush to act on the bill this year.

### **Clayton making good on pledge to curb SEC’s enforcement powers**

The SEC filed 62 enforcement actions against public companies and their subsidiaries in the 2017 fiscal year ended in October, a 33 percent drop from a year earlier. Only 17 were filed in the second half of the year, a time when SEC enforcement actions tend to increase. Monetary settlements against public company defendants also fell from the first half of fiscal 2017 to the second half, declining to \$196 million from \$1 billion. The SEC isn’t saying much about the reasons for the change, other than to note that it corresponds to a change in leadership at the SEC. New SEC Chair Jay Clayton was confirmed by the Senate in May.

### **Korn Ferry recommends performance pay for the Board**

A new paper from Korn Ferry advises board members to “think like activists” in assessing issues facing the companies they serve. It’s up to them, the strategic advisory firm contends, to get ahead of an activist campaign by figuring out ahead of time where the company is vulnerable. That includes, they say, asking hard questions and consider alternatives, connecting with shareholders, and ensuring that the board is fresh and focused. Most surprising is their last idea: Directors should be compensated based on performance goals, like management.

### **As the date to institute the new revenue recognition standard approach confusion reigns**

Few companies have told investors how their revenue trends could be impacted by the new revenue-recognition standard, according to a recent CFA Institute survey. Most say that they don’t understand the standard well enough to give investors that insight. SEC Deputy Chief Accountant Sagar Teotia is sympathetic, saying the complexity of the new standard is a problem. He said they are fielding 15 percent more inquiries than usual for a new regulation, as well as seeing a lot of confusion from their enforcement officers. While he expects compliance and disclosure to improve through 2018 as companies become more familiar with the new rules, his department will be lenient as long as it is obvious that management is trying to comply.

### **One early tax-law beneficiary: Chick-fil-A**

One industry is already getting its stimulus from the GOP tax bill this year – the tax consulting and lobbying business. And it’s having spinoff benefits for others as well. As one of an estimated 400 Washington consultancies and think tanks grinding out tax-policy position and impact statements, the Tax Foundation is holding twice as many events as usual this year. The Foundation’s event planner, Shannon Salzman, says some events have tripled in size from a year ago. Like most of her peers, Saltzman uses free food to lure attendees, and she finds lunch is easiest. Her secret weapon? Chick-fil-A. "If we can't get Chick-fil-A, we will often work with the Senate's catering house," she said. "A nice sandwich spread. Just general lunch food."

*At this special time of year, we pause to remember that our business relies on the trust and confidence of the good people it is our fortune to work with. We appreciate your kindness and concern for us, and we want you to know how much we enjoy both our professional and personal relationships with you. In the New Year, we hope that we can continue to support you and your business, but equally important, we wish for continued friendship, and good health for you and your families throughout the year.*



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