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Earnings Lies And Why Munger Says 'EBITDA Is Bull S***'



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Just like the hit series "House Of Cards," Wall Street earnings season has become rife with manipulation, deceit and obfuscation that could rival the dark corners of Washington D.C...



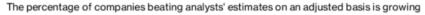
Back in the '80s and early '90s, companies used to report GAAP earnings in their quarterly releases. If an investor dug through the report, they would find "adjusted" and "pro forma" earnings buried in the back.

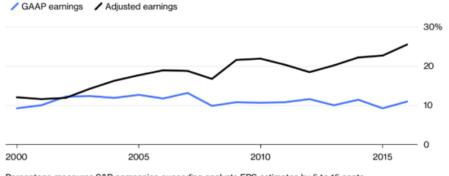
Today, it is GAAP earnings which are buried in the back hoping investors will miss the ugly truth...

However, research presented by the <u>American Accounting Association</u> suggests that companies engage in "asymmetric" non-GAAP exclusions of mostly unfavorable items as a tool to "beat" analyst earnings estimates...

...The <u>American Acccounting Association</u> found that over the past decade or so, more companies have shifted to emphasizing adjusted earnings. But those same companies' results under generally accepted accounting principles, or GAAP, often only match or slightly exceed analysts' predictions.

A Growing Gap





Percentage measures S&P companies exceeding analysts EPS estimates by 5 to 15 cents.

Source: Griffin and Lont

BloombergOpinion

"There are those who might claim that so far this century the U.S. economy has experienced such an unusual period of economic growth that it has taken analysts and investors by surprise each quarter ... for almost two decades. This view strains credulity." - Paul Griffin, University of California & David Lont, University of Otago

After reviewing hundreds of thousands of quarterly earnings forecasts and reports of 4,700 companies over 17 years, Griffin and Lont believe companies shoot well above analysts' targets because consistently beating earnings per share by only a penny or two became a red flag.

"If they pull out all the accounting tricks to get their earnings much higher than expected, then they are less likely to be accused of manipulation."

The truth is that stocks go up when companies beat their numbers, and analysts are generally biased toward wanting the stock they cover to go up. As we discussed in <u>"Chasing The Market"</u>, it behooves analysts to consistently lower their estimates so companies can beat them, and adjusted earnings are making it easier for them to do it...