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Pandemic spawns new reporting term 'Ebitdac' to flatter books

From Financial Times, 13th May 2020

Companies have always strived to present their financial results in the most flattering light. Now some are going a step further, presenting a new customised metric they are calling *EBITDAC*: earnings before interest, tax, depreciation, amortisation — and coronavirus.

This week Schenck Process, a German manufacturing group, added back €5.4m of first-quarter profits that it said it would have made were it not for the hit caused by state-mandated lockdowns. [1] Its operating profit for the period — "adjusted Ebitdac" of €18.3m — was almost 20 per cent higher than the same period a year earlier, rather than 16 per cent lower.

Schenck Process is not the only company tinkering with the presentation of its results. When The Azek Company, a Chicago-based manufacturer of building products, raised $325m of junk bonds last week it included a term that would allow it to add back "lost earnings" as a result of Covid-19 in future. [2] That was a first for the corporate debt market, according to research firm Covenant Review.

But the adding-back of profits lost to the viral outbreak has bemused some observers.

"When you're looking at coronavirus, these revenues will never come back; it is literally a fiction," said Sabrina Fox, executive adviser at the European Leveraged Finance Association.

The add-back was "not ideal", said Rob Jones, senior credit analyst at Insight Investment, an asset manager. He said such adjustments went beyond the usual tweaks that companies made to polish their numbers. "These are lost earnings you're adding back, as opposed to potential earnings added on."

Schenck Process, which was bought by private equity firm Blackstone in 2017, declined to comment. [3] Some companies that have seen their revenues plunge due to nationwide lockdowns have already sought waivers from their banks to ease their discomfort.

"How can they quantify whether a loss in revenue is purely down to coronavirus and not revenue they've lost to competitors or for regulatory reasons?" asked Nick Kordowski, Edinburgh-based head of fixed income non-financial research at Aberdeen Standard Investments.

Schenck Process included "Ebitdac" in its glossary of terms used in its first-quarter presentation, alongside more familiar acronyms such as A/P (accounts payable) and ESG. [4]

Ms Fox of the ELFA said the trend should be resisted. "It's a bit ironic to say we're adding back the effects of coronavirus to deal with the effect of coronavirus," she said.

Task 1. *Read the article and answer the following questions on it in your own words:*

1. What is the text about? Resume it in three lines.
2. What objection(s) to adding back losses due to coronavirus is/are mentioned in the article?
3. What does the underlined word hit mean?
4. Where [1-4] would you insert this sentence into the article? Write the figure in [square brackets].

   Other investors say they are concerned that increased usage of this new brand of Ebitda could allow companies to relax restrictions on how much they can borrow.
5. Why do you think Rob Jones said such adjustments went beyond the usual tweaks that companies made to polish their numbers?

Task 2. *Translate into English:*

De nombreuses sociétés, victimes des conséquences de la pandémie de Covid-19, enregistrent de mauvaises performances depuis le début de l'année. Pour embellir leurs résultats, raconte le Financial Times, certaines ont élaboré un indicateur prenant en compte les pertes liées au coronavirus.

Les entreprises se sont toujours efforcées de présenter leurs résultats financiers sous le jour le plus flatteur. Aujourd'hui, certaines ont franchi une nouvelle étape. Elles se sont dotées d'un nouvel indicateur, qu'elles ont baptisé Ebitdac: le bénéfice avant intérêts, impôts, dépréciation, amortissement et coronavirus.

Task 3. *Conjugate the verbs in the following paragraphs, taken from a newspaper article. The tenses used are present simple or present perfect. You may have to use the passive voice.*

In general, companies ___ (say) that non-GAAP measures ___ (provide) a better representation of how their business ___ (manage) than some official U.S. GAAP figures do, and many investors also find that it ___ (be) useful to get management's perspective on the company's operations. However, the use of adjusted earnings ___ (increase) in the past several years because non-GAAP financial metrics ___ (tend) to show higher figures than comparable GAAP numbers that ___ (audit). This would in turn boost the company's stock prices.

Among non-GAAP metrics, companies ___ (tout) EBITDA as true indicators during earnings calls, saying net income is meaningless for understanding their companies' performance. But for a number of years, companies ___ (customize) EBITDA and ___ (include) fewer costs in their unaudited income statements and made it difficult for analysts to do a fair comparison and understand the items taken out. And if a company ___ (use) EBITDAC to include speculative earnings, it will be taking the non-GAAP metric to the next level of sketchiness.

Task 4. *Match the following auditing terms (1-12) with the correct definition (b-m) on the right. For example,* ***0 – a***

0. statutory audit	a. required by law
1. dual-purpose test	b. direct tests of financial statement balances (substantive audit procedures) that are not analytical procedures
2. completeness testing.	c. audit procedures used to determine whether transactions have been recorded within the correct reporting period
3. occurrence testing.	d. audit procedures constructed to determine whether the transactions that a client is claiming have actually taken place
4. nature of audit testing	e. audit procedures are used to determine whether assets are owned
5. parallel simulation testing	f. time period when the procedure is performed
6. programmed controls	g. audit procedures testing to see if any transactions are missing from the accounting records
7. substantive audit procedure	h. process of simulating data processing with a set of data (from client) and comparing these results with that of client's system results
8. existence testing.	i. an audit procedure that is used as both a test of controls and a substantive test
9. rights and obligations testing.	j. a direct test of a financial statement balance designed to detect material misstatements at the assertion level; the procedures comprise tests of details (classes of transactions, account balances, and disclosures), and substantive analytical procedures
10. test of detail	k. audit procedures followed to see if a client actually owns all of its assets
11. timing of audit testing	l. the type of testing, such as tests of internal controls, tests of transactions, or tests of balances in balance sheet accounts
12. tests of cutoff	m. the controls built into computer software and include reasonableness tests, control totals, and sequence checks

Task 5. *Read a comment on the article "Pandemic spawns new reporting term 'Ebitdac' to flatter books" and respond (8-10 lines).*

With the Coronavirus crisis continuing to put pressure on businesses, regulators and governments and with people still (mostly) locked down, it's good to see that the crisis seems to have brought out some special creativity. As reported pretty widely, a few brave companies, whether in an act of special creativity, or because they just wanted to make us laugh, have constructed a new financial term – EBITDAC. That's Earnings Before Interest, Tax, Depreciation, Amortisation and Covid!

Revenues have plunged because your customers have stayed at home? No problem, just report EBITDAC by adding back into your earnings what you wished you had earnt!

As expert Sabrina Fox, executive adviser at the European Leveraged Finance Association, comments in an item in the Financial Times "It's a bit ironic to say we're adding back the effects of Coronavirus to deal with the effect of Coronavirus"!

Well — quite! Now where had we read something about Non-GAAP metrics? Still – it made us laugh!