

# FP INVESTING

## COMMENT

### Tough to tell a CFO from an analyst

Distinctions fade as they perform each other's jobs

AL ROSEN

Some analysts and CFOs must really enjoy one another's company, because they are increasingly starting to perform each other's jobs.

It used to be that chief financial officers would make the strategic finance decisions necessary to steer the company, and would then report the results of those efforts to analysts. Analysts would then scrutinize the reported results and make any adjustments and other estimates needed to value the company on a forward-looking basis. Somewhere along the way, the traditional line between those duties got considerably blurred.

Nowadays, it seems that some sell-side analysts believe it is their duty to write research outlining how companies should restructure or spin off various parts of the businesses. For some analysts, these so-called research reports are starting to outnumber traditional reports that dig into company results and ferret out critical industry trends.

A few telecom analysts, in particular, would have done well to do some research on how VOIP

technology would turn the industry on its head instead of continually pontificating about how the large industry players should turn into income trusts.

It doesn't seem fair to mention these analysts by name, seeing as they are hardly alone when it comes to playing CFO, rather than simply doing their jobs to the benefit of their investor clients.

## ANALYSTS KNOW WHO

### REALLY BUTTERS

#### THEIR BREAD

As always, some will think that I'm being too hard. After all, many sell-side analysts will admit that they are pressured into drumming up business for the investment banking division of their company. This can be through either finding companies that might want to pursue an initial public offering, or by getting public companies to undertake some sort of spin-off that generates underwriting fees.

While this obvious conflict is not supposed to exist, the revenue imbalance on the sell side makes it a continuing certainty. Most sell-side research only exists because it is subsidized by revenues from investment banking and trading. And, while analysts' salaries are not supposed to be based upon investment banking revenues, most analysts are not stupid people, and they know who really butters their bread.

Nevertheless, those are the realities of non-independent, sell-side research, and investors will continue to see a flurry of investment banking-oriented "research" even though the managers and owners of the businesses are more than capable of carrying out such analyses on their own.

On the flip side of this role confusion are corporate CFOs who really want to be research analysts. Companies have, for some time now, tried to outdo each other in presenting higher and higher, incomparable measures of performance.

The trend began by executives excluding so-called "one-time" items from their reported earnings. This was the start of the slippery slope, because as soon as investors accepted this argument, the one-time items became increasingly negative amounts, and much more frequent in their occurrence.

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## Trusts cover up poor earnings

ROSEN

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From there, the march continued up the income statement with managers continuing to strip away lines of expenses in order to improve the company's perceived performance.

Excluding certain expense items can be a legitimate exercise for research analysts in order to even out factors such as weak accounting rules. However, it becomes very dangerous when companies are allowed to present their own views of reality, and to provide them in a way that suggests they represent the longer-term earnings power of the company.

I'm speaking about income trusts and the use of distributable cash figures to cover up poor earnings. I've looked at more than 50 different income trusts, and I'm surprised by what some companies are doing. For one, there's **Aeroplan Income Fund**, which calculates its distributable cash based on low-ball estimates of future expenses. The company's only explanation for this is that it will readily devalue its customers' points if it needs to keep costs under control.

Another example is **Yellow Pages Income Fund**, which reports "distributable cash" that sometimes excludes actual cash that was spent during the period. In contrast, the historical, comparable, earnings-oriented performance measure (otherwise known as net income) gets severely downplayed.

The problem is that most peo-

## I JUST WISH SOMEONE WOULD START DOING THE REGULATORS' JOB

ple think distributable cash is a historical reflection of the cash flows earned by a company during the period. This is frequently wrong on two counts.

First, the cash flows might not be earned, but might merely be "borrowed" and still owed to another party down the line. Second, is that some CFOs are starting to issue quasi-earnings forecasts rather than historical results.

Similar to analysts who might value a company based on an estimate of next year's earnings after making several adjustments, some CFOs are attempting to report last year's results under a "what if things had gone better" view.

For instance, **Yellow Pages** describes its distributable cash as "the cash generated from the ongoing operations of the business considering the comparability of that measure from period to period."

It would take a psychic to decipher what the company means by "considering the comparability of that measure from period to period." But evidently, it means they can exclude cash outflows that weren't there in the prior period. It doesn't bring the cash back, but it certainly looks better on paper.

Apparently, this is all kosher with our financial regulators, as long as companies provide a boilerplate disclaimer stating that their results "may not be comparable to other companies." Unfortunately, comparability is the very core of useful valuation analysis.

Yet, never mind the role confusion of some analysts and CFOs. I just wish someone would start doing the securities regulators' job, seeing as those cashing the handsome paycheques seem to have long ago lost any interest in protecting investors.

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