Reporting Key Metrics: What You Need to Know

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Overview of Key Metrics

• What are key metrics?
  – Public investors look for operating metrics that management uses to measure and run the business
  – Enables investor understanding of key business levers, business strategy and initiatives
  – Helps sell-side and buy-side analysts model and track the business appropriately
Overview of Key Metrics (cont’d)

– Key metrics are often used to show:
  ▶ Growth
    – number of customers
    – number of users
  ▶ Visibility
    – customer retention
    – renewal rates
    – billings
  ▶ Upsell Potential
    – dollar retention
    – churn
    – cohort analysis
Choosing Key Metrics

• Identify key drivers that help management forecast operating results and make investment decisions

• Consider how key metrics relate to the company’s strategic objectives
  – What drives changes in business and financial performance?
  – How do key metrics track the company’s performance and prospects?

• How will the MD&A narrative use those metrics to explain changes in the company’s financial results?

• Assess the intended relationship between key metrics and executive compensation

• Consider which metrics peer companies and others in the industry use
Disclosing Key Metrics

- IPO prospectus and roadshow deck will include key metrics and highlight trends.
- Post-IPO, companies generally disclose key metrics on a quarterly and annual basis in their public reporting.
  - Consider the metrics that will work best over time.
- Key metrics should be readily verifiable with a transparent calculation methodology.
  - Benchmark calculation methodology against competitors.
  - Explain areas where metrics require judgment on the part of management.
  - Validate and test methodology for calculating early in IPO process.
- Presentation of key metrics that are non-GAAP financial measures are required to comply with the SEC rules on disclosure.
Rules Governing Non-GAAP Financial Measures

• **Regulation G**: applicable to all public disclosure of non-GAAP financial measures

• **Item 10(e) of Regulation S-K**: applicable to SEC-filed documents

• **Form 8-K**: specific guidance for applicability of Item 10 to earnings releases and other financial information furnished under Item 2.02

• **Compliance and Disclosure Interpretations (C&DIs)**: guidance regarding areas of specific SEC focus
Equal or Greater Prominence for GAAP Measures

• When a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence
• Area of focus for SEC comments
• Disclosures that would cause a non-GAAP measure to be more prominent:
  – Presenting a full income statement of non-GAAP measures
  – Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures
  – Using a style of presentation that emphasizes non-GAAP measure over GAAP measure
  – Non-GAAP measure precedes the most directly comparable GAAP measure (including in an earnings release headline or caption)
Equal or Greater Prominence (cont’d)

- Disclosures that would cause a non-GAAP measure to be more prominent:
  - Describing a non-GAAP measure as, for example, “record performance” or “exceptional” without GAAP disclosure
  - Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures
  - Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence
Performance versus Liquidity Non-GAAP Measures

- Non-GAAP financial measures that are liquidity measures are distinguished from those that are performance measures under the C&DIs
- SEC may not agree with registrant’s determination
- Non-GAAP financial measures that are liquidity measures cannot be presented on a per share basis
- EBIT and EBITDA may not be presented on a per share basis, even if management believes these are performance measures (SEC staff position: these are liquidity measures)
Non-GAAP Liquidity Measures: Free Cash Flow

- Free Cash Flow (FCF) has different meaning to different companies
- Typical definition of FCF is net cash provided by (used in) operating activities, minus purchases of property and equipment
- Companies should explain how their FCF measure is calculated, provide the necessary reconciliation, and be careful when describing the reasons why FCF is a useful metric
Problemsatic Non-GAAP Measures and Presentations

• Exclusion of recurring cash operating expenses
  – Presenting a performance measure that excludes normal, recurring cash operating expenses necessary to operate a registrant’s business could be misleading
  – Certain adjustments, although not explicitly prohibited, can result in a non-GAAP measure that is misleading

• Certain revenue presentations
  – Non-GAAP measures that adjust to accelerate revenue recognized ratably over time in accordance with GAAP
  – Individually tailored recognition and measurement methods for financial statement line items other than revenue may also violate Regulation G

• Inconsistent presentations across periods
  – A non-GAAP measure can be misleading if it is presented inconsistently between periods

• Presenting an incomplete picture
  – A non-GAAP measure can be misleading if the measure excludes charges but does not exclude any gains
Non-GAAP Enforcement Sweep

- In addition to comment letters from the SEC’s Division of Corporation Finance, the SEC’s Division of Enforcement has sent letters to some companies asking about past compliance with non-GAAP rules
- The enforcement action evidences the SEC’s focus on non-GAAP measures
Recommended Action Items

• Identify key metrics that help management operate the business
• Consider benchmarking against peers
• Discuss key metrics with banking, legal and accounting teams
• Review use of non-GAAP financial measures in light of the latest SEC guidance and prepare disclosure accordingly
• Ensure controls and procedures are in place to report metrics
Thank you!

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