THE USE OF ALTERNATIVE PERFORMANCE MEASURES IN FINANCIAL INFORMATION

CURRENT PRACTICE OF EUROPEAN LISTED COMPANIES

FACT FINDINGS FROM MAZARS BENCHMARKING

Mazars AIAF - Roundtable – Milan, 29 November 2016
BACKGROUND
WHAT ARE « APMS »?

What are Alternative Performance Indicators?

- Financial measures of historical or future financial performance, financial position, or cash flows
- Sometimes referred to as Non-IFRS or Non-GAAP
- Derived from IFRS financial statements, adding or subtracting amounts from the figure presented therein
- They are not defined nor specified in the applicable financial reporting framework

What distinguishes them from GAAP information?

What is their role?

- To convey the entity’s performance which is more closely aligned to management’s view
- Widespread use
WHY A DISCUSSION ON APMS NOW?

- Promote usefulness and transparency of APMs. Prospectuses, financial reports and market disclosures in scope
- Principles addressing the labelling, calculation, presentation and comparability
- National regulators under Transparency Directive, Prospectus Directive or Market Abuse to monitor compliance
- Inconsistencies observed in practice for the statements of profit or loss
- Examining possible changes to primary financial statements, such as including a defined subtotal for operating profit
- Examining use of alternative performance measures

ESMA Guidelines effective July 3, 2016

IASB research project on Primary Financial Statements
IAS 1 REQUIREMENTS FOR ITEMS « ON THE FACE »

Additional items to be added on the face

- Relevant to understand financial position or the entity’s financial performance
- Calculated and presented in an unbiased fashion

Presentation

- Subtotals include IFRS items, presented and labelled in a clear and understandable way, consistently presented from period to period
- Not displayed with more prominence than subtotals and totals required by IFRS Standards

Prominence

- ‘Operating profit’: misleading if items of an operating nature (e.g. business combination impacts, depreciation of assets or inventory write-downs) are excluded

Operating profit

Extraordinary items

- Do not present extraordinary items and use meaningful labels, e.g. items affecting more than one period rarely can be non-recurring such as most of the restructurings costs or impairment losses
**ESMA GUIDELINES’ KEY REQUIREMENTS**

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>Definition, components, basis of calculation, details of any material hypotheses or assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Definitions of all APMs used in clear and readable way</td>
</tr>
<tr>
<td></td>
<td>Meaningful labels reflecting content/preparation basis to avoid conveying misleading messages</td>
</tr>
<tr>
<td>Presentation</td>
<td>Reconciliation to the most directly IFRS reconcilable item presented in the financial statements, separately identifying and explaining material reconciling items</td>
</tr>
<tr>
<td></td>
<td>Present the most directly reconcilable item relevant for that specific APM</td>
</tr>
<tr>
<td>Reconciliation</td>
<td>Accompanied by an explanation of the use of APMs to understand their relevance and reliability</td>
</tr>
<tr>
<td>Explanation of use</td>
<td>Not displayed with more prominence, emphasis or authority than IFRS measures</td>
</tr>
<tr>
<td>Prominence</td>
<td>Comparatives for previous periods and consistency overtime</td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
</tbody>
</table>
Investigating commonalities at segment level

IAS 1 and ESMA requirements as reference points

Categorising APMs into “presented on the face”/”direct”/”indirect”, based on the degree of reconcilability with GAAP measures

Financial report 1H16, YE15 (special focus on Management Commentary)

Press releases

Presentation to the analysts

4 segments

- Industrial (37 entities)
- Insurance (4 entities)
- Banking (8 entities)
- Real Estate (1 entity)

Scope: listed entities belonging to the EUROSTOXX 50 index

Financial information analysed

Benchmarking analysis on current use of APMs in financial reporting
LIST OF APMs COMMONLY USED BY SEGMENT AND THEIR PRESENTATION
| Performance | Operating profit/Adjusted Operating profit | Cost/income ratio | ROE | ROA | ROTE | Adjusted net result/net income | Adjusted ROE,ROTE,RONE | Like-for-like and organic growth figures |
|-------------|------------------------------------------|------------------|-----|-----|-----|-------------------------------|------------------------|---------------------------------
| Risk        | NPL or impaired ratio                   | NPL or impaired coverage ratio | Coverage ratio for performing loans | Cost of risk | Cost of risk by segment | Value at risk |
| Regulatory defined indicators of capital | CET 1 ratio fully loaded | CET 1 ratio phased-in | Tier 1 ratio | Risk-Weighted-Assets | Risk-Weighted-Assets by risk | Risk-Weighted-Assets by sector |
| Regulatory defined indicators of liquidity | Leverage ratio fully loaded | Leverage ratio phased-in | Liquidity Coverage Ratio |

- Operational Profit/Adjusted Operating Profit
- Cost/income ratio
- Return on Equity (ROE)
- Return on Assets (ROA)
- Return on Tangible Equity (ROTE)
- Adjusted net result/net income
- Adjusted ROE, ROTE, RONE
- Like-for-like and organic growth figures
- NPL or impaired ratio
- NPL or impaired coverage ratio
- Coverage ratio for performing loans
- Cost of risk
- Cost of risk by segment
- Value at risk
- CET 1 ratio fully loaded
- CET 1 ratio phased-in
- Tier 1 ratio
- Risk-Weighted-Assets
- Risk-Weighted-Assets by risk
- Risk-Weighted-Assets by sector
- Leverage ratio fully loaded
- Leverage ratio phased-in
- Liquidity Coverage Ratio

Regulatory defined indicators of liquidity and capital:
- Operational Profit/Adjusted Operating Profit
- Cost/income ratio
- ROE
- ROA
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- Adjusted net result/net income
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Risk management and performance:
- NPL or impaired ratio
- NPL or impaired coverage ratio
- Coverage ratio for performing loans
- Cost of risk
- Cost of risk by segment
- Value at risk
INSURANCE SEGMENT

- Direct Indicators
- Indirect Indicators
- Solvency Ratio

- New Business Value - Life
- Return On Equity ("ROE")
- Combined ratio Non-Life %
- Expense Ratio
- Annual Premium Equivalent ("APE") - Life
- Current accident year or loss ratio...
- New Business Margin
- Assets Under Management
- Adjusted earnings/Operating result
- Adjusted ROE
- Regulatory Solvency Ratio
- Economic Solvency Ratio

o/w on the face 2
None of the entities comment OCI in their management commentary, in the press release nor in the presentation to the analysts.

No APMs were presented with reference to components of OCI in the documents analysed.
SELECTED FINDINGS ON KEY APMs
**INDUSTRIAL SEGMENT**

- 2 (out of 4) entities present operating profit on the face income from entities accounted for using the equity method and change in goodwill: different presentation

- 2 (out of 4) present an operating profit elsewhere, but with significant divergences in calculation. Items excluded:
  - amortisation of business combinations (2);
  - interest expenses on external debt (2);
  - P&L from instruments FVTPL (2);
  - disposal of investments (1);
  - one-off/non recurring general exp. or pension revaluation (2);
  - corporate restructuring

**INSURANCE SEGMENT**

- 2 (out of 4) entities present operating profit on the face income from entities accounted for using the equity method and change in goodwill: different presentation

**REAL ESTATE SEGMENT**

- The company introduces two subtotals on the face of its consolidated Income Statement
  - Net Operating Result before Financing Costs (also defined as “EBIT”)
  - Net Rental Income.
DIVERGENCES IN EBIT CALCULATION AND LABELLING - 2/2

BANKING SEGMENT

Share of profit or loss of investments accounted for using the equity method

- Included in Gross Income
- Excluded from Gross Income

Loan loss provisions presentation

- Included in Operating Expenses

Integration/restructuring costs presentation

- Included in Operating Expenses
- Excluded from Operating Expenses

Impairment of available-for-sale financial assets

- Included in Gross Income
- Included in Operating Expenses
- Excluded from both Gross Income and Operating Expenses

Impairment of PP&E

Impairment of Intangible Assets

Impairment of Goodwill

Impairment charges within Operating Expenses

Labelling of EBIT

Never identified as EBIT, but as operating income, operating margin or operating profit.

On top, 2 banks exclude SRF charges from operating profit

Same divergence in COST/INCOME ratio (used by all the banks)
MANAGEMENT FOCUSES ON ADJUSTED EARNINGS, NET OF SPECIAL/ONE-OFF TRANSACTIONS - 1/2

INDUSTRIAL SEGMENT

- 32 entities out of 37 use adjusted performance indicators and 12 present it on the face
- 83% of the adjustments result in positive effect
- 6 entities changed result from negative to positive

Frequency of adjusted indicators in the Income Statement

- No Adjusted indicators in Income Statement
- French entities that included adjusted indicators in the Income Statement
- Belgian entity that included adjusted indicators in the Income Statement

Label “NON RECURRING”

63% of the entities define as “non-recurring” items that are likely to influence future periods.

Adjusted indicators of performance:
common reconciling items

- Disposal of business: 41%
- Litigation costs: 44%
- Impairment of PPE: 56%
- Disposal of PPE: 56%
- Acquisition related costs*: 63%
- Impairment of intangibles and/or goodwill: 69%
- Restructuring: 78%
MANAGEMENT FOCUSES ON ADJUSTED EARNINGS, NET OF SPECIAL/ONE-OFF TRANSACTIONS - 2/2

BANKING SEGMENT

- 6 entities out of 8 use adjusted net result in press releases and/or presentations
  - of which 2 present also it in management commentaries and 1 on the face ("underlying result")

- Adjustments to IFRS net result
  - disposal of an investment (6);
  - non-recurring/extraordinary items (5);
  - CVA/DVA and own credit risk (3);
  - spreading IFRIC 21 SRF charges (1);
  - provisions for “PEL/CEL” (2 French banks);
  - gain upon disposal accounted for after reporting period (1)

INSURANCE SEGMENT

- 1 out if 4 uses Adjusted earnings, excluding P&L on FVO and derivatives, exceptional operations other than discontinued, integration and restructuring costs

REAL ESTATE SEGMENT

- “Non-recurring” items:
  - valuation movements;
  - disposals;
  - mark-to-market and termination costs of financial instruments;
  - impairment and negative goodwill;
  - business combination costs.
## Divergences in ROE Calculation

<table>
<thead>
<tr>
<th><strong>Industrial Segment</strong></th>
<th><strong>Banking Segment</strong></th>
<th><strong>Insurance Segment</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Used by 11 entities out of 37</td>
<td>Used by 6 entities out of 8</td>
<td>Used by 3 entities out of 4</td>
</tr>
<tr>
<td>7 different formulas</td>
<td>3 different formulas</td>
<td>Adjusted in all cases without labelling “adjusted”; 1 presents IFRS ROE alongside it</td>
</tr>
<tr>
<td>- Inclusion and exclusion of minorities from either numerator or denominator or both</td>
<td>- Inclusion and exclusion of minorities from either numerator or denominator or both</td>
<td>2 different formulas</td>
</tr>
<tr>
<td>3 different labelling for the same performance indicator</td>
<td>- Differences exist in the components of equity that are taken into account in the denominator</td>
<td>- Denominator (excluding of shadow DAC Deferred Acquisition Costs)</td>
</tr>
<tr>
<td></td>
<td>- Unclear in one case how negative reserves were considered</td>
<td>- Numerator (excluding interest expenses) and denominator (exclusion of items of OCI)</td>
</tr>
</tbody>
</table>
### BANKING SEGMENT

**Problem loans**

- Coverage ratio: used by all the entities
- Ratio of problem loans used by 7 entities out of 8

**Divergences across countries**

- **Labelling**
  - 5 entities refer to NPL: 2 Italian entities state definition consistent with EBA’s ITS and 3 do not clarify
  - 2 French entities refer to “Doubtful loans”

- **Calculation of coverage ratio**
  - 2 Spanish banks take into account both the loans and the contingent liabilities
  - 6 remaining only include loans

### INSURANCE SEGMENT

- All entities make extensive use of APMs not presented on the face

- APMs used mainly non-reconcilable by nature, except for operating profit, adjusted earnings and ROE
QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION PRODUCED USING APMS
**APMS WELL EXPLAINED BUT HAVE MORE PROMINENCE THAN IFRS ITEMS, ESPECIALLY IN THE PRESS RELEASES**

<table>
<thead>
<tr>
<th>INDUSTRIAL SEGMENT</th>
<th>BANKING SEGMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosure and definitions</td>
<td>Definitions presented disclosure satisfactory</td>
</tr>
<tr>
<td>- Clear basis for calculation (96%)</td>
<td>- Many APMs are regulatory defined</td>
</tr>
<tr>
<td>- Definitions (99%) clear and readable</td>
<td></td>
</tr>
<tr>
<td>- 85% of the APMs are labelled correctly; not clear as they relate to adjusted</td>
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<tr>
<td>Prominence: Management commentary</td>
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</tr>
<tr>
<td>- Adjusted indicator and its GAAP most reconcilable measure presented together (94%)</td>
<td>- APM and most reconcilable IFRS item stated together</td>
</tr>
<tr>
<td>Prominence: Press releases</td>
<td>Prominence: Press release and presentation to analysts</td>
</tr>
<tr>
<td>- 59% of the entities provide only the adjusted APM not stated together with the most reconcilable IFRS item</td>
<td>- Indicators affected by managerial adjustments presented with equal and in some cases more prominence than the IFRS equivalent measures</td>
</tr>
<tr>
<td>6 companies of the 32 that use adjusted indicators give more prominence to them</td>
<td></td>
</tr>
<tr>
<td>INDUSTRIAL SEGMENT</td>
<td>BANKING SEGMENT</td>
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<tr>
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</tr>
<tr>
<td>97% of the APMs are presented with comparatives</td>
<td>Comparatives for key APMs always presented</td>
</tr>
<tr>
<td>4 entities out of 37 made changes in 1H16</td>
<td>2 out of 8 introduced a section dedicated to APMs in 1H16</td>
</tr>
<tr>
<td>7 out of 37 have a section dedicated to APMs</td>
<td>4 out of 8 have a separate section on APMs, remaining 4 have an Appendix/Glossary</td>
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