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Client**Alert**

Capital Markets

January 2010

Revised Compliance and Disclosure Interpretations on Non-GAAP Financial Measures

On January 11, 2010, the staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission (the "SEC") issued new Compliance and Disclosure Interpretations relating to Regulation G and Item 10(e) of Regulation S-K (the "2010 CD&Is"). The 2010 CD&Is include new and revised interpretations on the use of non-GAAP financial measures and provide registrants with more flexibility to disclose non-GAAP financial measures in filings with the SEC.

Regulation G and Item 10(e)

Regulation G and Item 10(e) were adopted by the SEC in 2003 to regulate the use of non-GAAP financial measures, as directed by the Sarbanes-Oxley Act of 2002. Regulation G requires public companies that disclose or release material information that includes a "non-GAAP financial measure" to include a presentation of the most directly comparable GAAP financial measure and a reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure. Item 10(e) regulates the use of non-GAAP financial measures included or incorporated by reference in SEC filings. Item 10(e) requires more extensive disclosure relating to non-GAAP financial measures, including substantive justification for their use, and imposes restrictions on adjustments that may be made to non-GAAP financial measures, including prohibiting adjustments of non-GAAP performance measures to eliminate or smooth certain items identified as nonrecurring, unusual or infrequent, and prohibiting exclusion from non-GAAP liquidity measures (other than EBIT and EBITDA) of items that will require cash settlement.

Interpretive guidance relating to Regulation G and Item 10(e)

Following the adoption of Regulation G and Item 10(e), the SEC issued interpretive guidance in the "Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures," published in June 2003 (the "2003 FAQs"). The 2010 CD&Is replace the guidance provided in the 2003 FAQs and include new and revised interpretations with respect to the following:

Nonrecurring items. Item 10(e) prohibits adjusting a non-GAAP performance measure to eliminate or smooth items identified as nonrecurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. The Staff has clarified in the 2010 CD&Is that the prohibition is based on the *description* of the item that is being adjusted rather than on the *nature* of the charge or gain. The Staff notes that the fact that a registrant is unable to describe an item as nonrecurring, infrequent or unusual does not mean that an adjustment may not be made for that item. Instead, registrants may make adjustments they

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believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K.

As a result, companies may adjust a performance measure for recurring items they believe are appropriate, provided they do not characterize such items as nonrecurring, infrequent or unusual unless such items in fact meet the specified criteria. For example, companies would be permitted to present as a performance measure EBITDA adjusted for recurring cash or noncash expenses. This represents a significant change from the SEC's previous position articulated in the 2003 FAQs, where the Staff listed significant burdens and conditions that registrants were required to meet in order to justify the elimination of recurring items. These included a demonstration of the usefulness of any non-GAAP financial measure that excluded recurring items, and an indication that inclusion of such measures may be misleading absent significant disclosure addressing how and why management used the measures and the material limitations associated with their use.

Use of non-GAAP financial measures in managing business. The 2010 CD&Is clarify that a registrant is not required to use a non-GAAP financial measure in managing its business or for other purposes in order to be able to disclose it. However, any additional purposes for which a non-GAAP measure is used should be disclosed, to the extent material, in accordance with Item 10(e).

Non-GAAP earnings per share. The 2010 CD&Is clarify that non-GAAP earnings per share numbers are not prohibited in documents filed or furnished with the SEC. The Staff notes that certain non-GAAP per share performance measures may be meaningful from an operating standpoint. Such non-GAAP per share performance measures should be reconciled to GAAP earnings per share. However, non-GAAP liquidity measures, such as cash flow, should not be presented on a per share basis, consistent with Accounting Series Release No. 142, Reporting Cash Flow and Other Related Data. As a result of this clarification, an issuer could, for example, present operating income per share provided that measure was reconciled to net income per share.

Free cash flow measures. Free cash flow measures—generally calculated as cash from operations less capital expenditures—are not prohibited in documents filed with the SEC. While a clear description of how the measure is calculated and a reconciliation should accompany the measure, the 2010 CD&Is no longer require that all material limitations of the measure be disclosed.

Use of Adjusted EBITDA in filings. Although Item 10(e) prohibits excluding from non-GAAP liquidity measures charges that are required to be cash-settled (other than EBIT and EBITDA), the 2010 CD&Is now formalize the SEC position that management may disclose Adjusted EBITDA in its MD&A as a liquidity measure if it believes that a credit agreement containing a covenant regarding Adjusted EBITDA is a material agreement, that the covenant is a material term of the credit agreement and that information about the covenant is material to an investor's understanding of the company's financial condition and/or liquidity. In such case, registrants should consider also disclosing (1) the material terms of the credit agreement, including the covenant, (2) the amount or limit required for compliance with the covenant and (3) the effects of compliance or noncompliance with the covenant on the registrant's financial condition and liquidity.

Presentation of full non-GAAP income statement. In general, registrants should not present a full non-GAAP income statement for purposes of reconciling non-GAAP measures to the most directly comparable GAAP measures, as it may attach undue prominence to the non-GAAP information. This interpretation applies to filings under Item 10(e) and other disclosures under Regulation G. Issuers should confirm, in particular, that their earnings releases do not violate this requirement.

Presentation of an adjustment "net of tax." Registrants may present an adjustment "net of tax" when reconciling a non-GAAP performance measure to the most directly comparable GAAP measure, provided that the tax effect of each reconciling item is disclosed parenthetically, in a footnote to the reconciliation, or in one line in the reconciliation. Registrants should also disclose how the tax effect was calculated.

REITS. In the 2010 CD&Is, the Staff explicitly accepts the National Association of Real Estate Investment Trusts' definition of the financial measure "funds from operations" (FFO) as a performance measure and states that if presented as a performance measure, it may be presented on a per-share basis. In addition, the Staff will accept the presentation of FFO on a modified basis, provided that any adjustments made to FFO comply with Item 10(e) for a performance measure or a liquidity measure, depending on how it is presented. If the adjusted measure is presented as a performance measure, it may be presented on a per share basis; however, if presented as a liquidity measure, it may not be.

Foreign private issuers. A foreign private issuer may demonstrate that a non-GAAP financial measure is "expressly permitted" by its primary securities regulator by providing evidence of explicit acceptance of a presentation by the primary regulator in its home country jurisdiction or market. Such evidence would include (1) published views of the regulator or members of the regulator's staff or (2) a letter from the regulator or its staff to the foreign private issuer indicating the acceptance of the presentation (such letter to be provided to the Staff upon its request).

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NYC/0110_CM_A_05245_v10