

Investing Like a Forensic Accountant

Retailed Learnings

Ben Graham Centre 2023
Value Investing Conference
Delta Hotels Toronto
April 19, 2023

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President & CEO



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Breaking the Mold

Accountant



Investor



What is Accounting For?

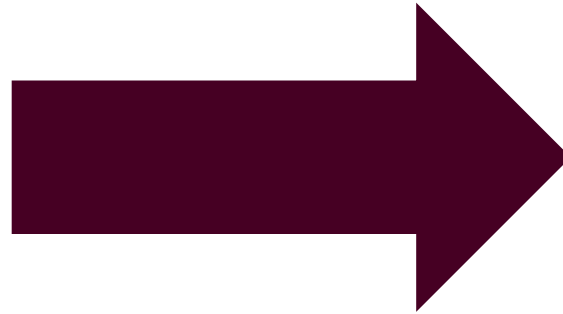
Compliance

Investors

Auditor

Journalists

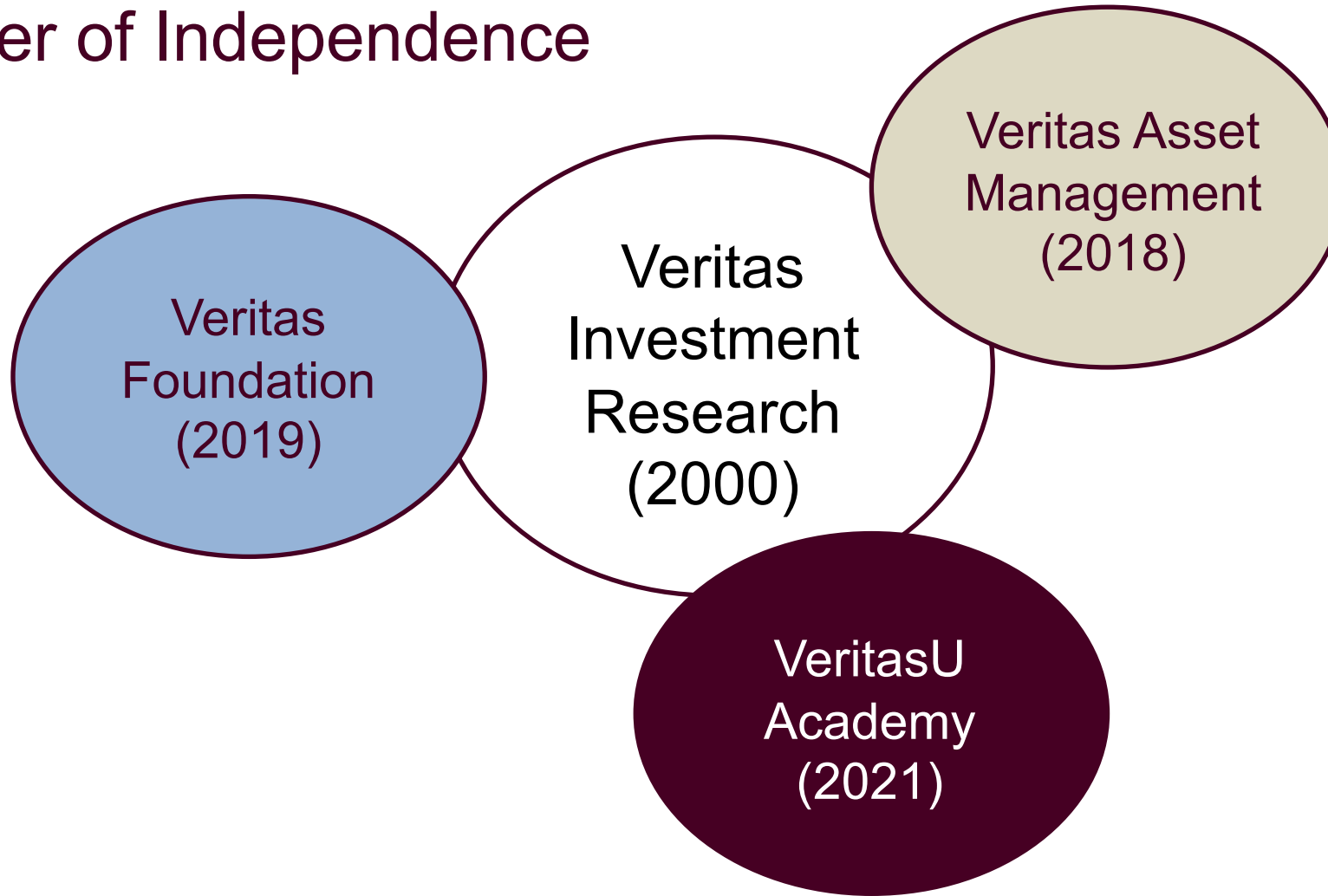
Employees



A Means
of
Communication



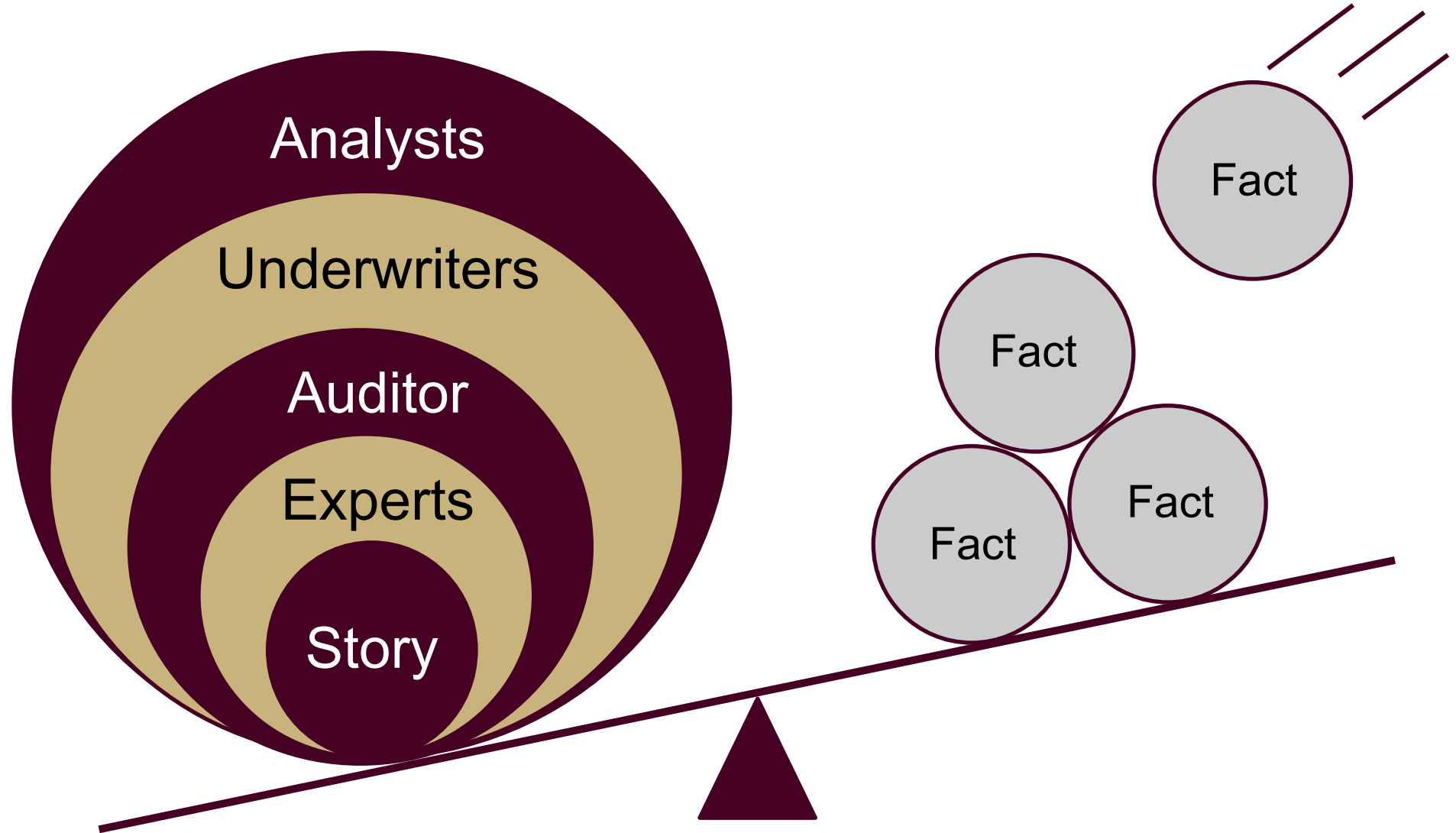
The Power of Independence



Empowering Investors' Capital Decisions



Question the Story



The Cause and Effect

Business Innovation = Earnings & Multiple Expansion

Accounting Innovation = Not Sustainable



The Forensic Approach - Evaluate Performance

Business Innovation (Organic/Acquisition)

or

Accounting Innovation



The Skeptical Optimist

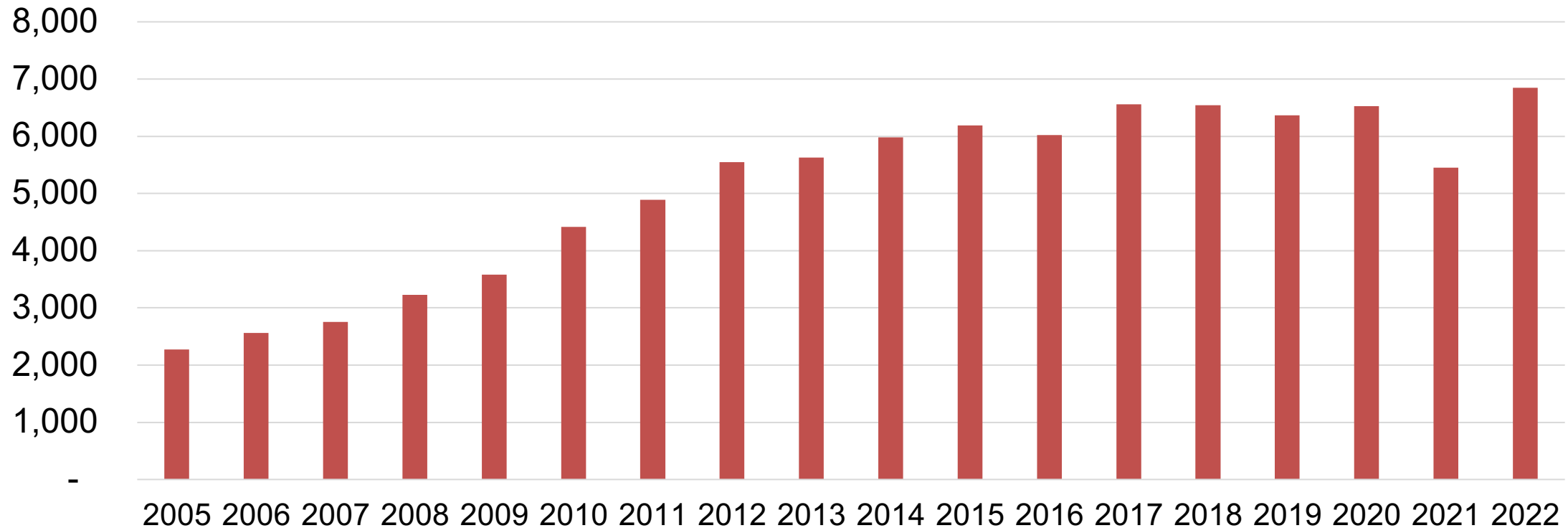
WHY?

*Because nothing happens
without a reason...*



The Growth of Non-GAAP

"Non-GAAP" or "Non-IFRS" Mentions in 10-K or Annual Report



Communicate the Story not the Facts...

Source: Alpha-sense: 10K/10KA - Annual filings, Annual Reports. Includes all North American public files.



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The Forensic Framework: Identifying Risks & Opportunities

1) Evaluate the Business & Reporting Control Environment

2) Identify Flammable Items

3) Look For Sparks



Nortel: Acquisition Accounting Story ... ©2000

A microcosm for the ills of the accounting and investment industries

- Investors pay for and expect growth
- Management will do anything not to disappoint

Nortel was once 66% of the TSX Index...



Nortel: Earnings in Accordance With... @2000

Fiscal Year: 2000 – millions USD	U.S. GAAP	Canadian GAAP	Nortel GAAP
Revenue	30,275	30,273	30,275
Cost of revenues	17,103	17,113	17,101
Gross profit	13,172	13,160	13,174
Selling, general & administrative	5,696	5,701	5,696
Research & development	4,005	3,839	4,005
In-process research & development	1,491	1,313	-
Amortization			
Acquired Technology	869	869	-
Goodwill	3,944	4,139	79
Stock option compensation	135	99	-
Special charges	271	273	-
Gain on share of business	(174)	-	-
Equity loss	33	34	11
Other income, net	(875)	(1,056)	(193)
Interest expense	169	169	169
Income (loss) before tax	(2,392)	(2,200)	3,407
Tax provision	1,078	757	1,100
Net earnings (loss) to common shares	(3,470)	(2,957)	2,307

Will the real numbers please stand up!



Nortel: Non-GAAP Metrics... ©2000

...from the 10K

As a measure to assess financial performance...

Supplementary measures of net earnings and earnings per common share should not be considered as an alternative to net earnings (loss) applicable to common shares and earnings (loss) before income taxes (as determined in accordance with Canadian GAAP).
[Emphasis added.]

Nobody cares until they care...then they care a lot

Source: Nortel 1999 10K



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Nortel: Story Communication

GAAP	Non-GAAP
Audited	Non audited
Standards	Anything you want
Consistent	Change at will

It's always easier when you can create your own scorecard



Nortel: Acquisition Composition... ©2000

Millions of USD	Date	Cash Stock	Purchase Price	Acquired Technology	IPR&D	Goodwill	Total Paid for Intangibles	Intangibles Purchase Price %
Dimension	24-Jan-00	Cash	52	-	-	45	45	87%
Photonic	12-May-00	Cash	32	-	-	29	29	91%
Cambrian	15-Dec-98	Cash	248	-	204	48	252	102%
Bay Networks	31-Aug-98	Stock	9,060	2,050	1,000	5,345	8,395	93%
Shasta	16-Apr-99	Stock	349	-	180	164	344	99%
Periphonics	12-Nov-99	Stock	481	66	68	271	405	84%
Qtera	28-Jan-00	Stock	3,004	-	559	2,412	2,971	99%
Clarify	16-Mar-00	Stock	2,114	210	64	1,812	2,086	99%
Promatory	23-Mar-00	Stock	771	60	50	659	769	100%
Xros	2-Jun-00	Stock	3,227	29	191	3,004	3,224	100%
Core Tek	23-Jun-00	Stock	1,203	115	176	946	1,237	103%
Architel	1-Jul-00	Stock	472	17	16	420	453	96%
EPiCON	5-Sep-00	Stock	284	13	6	262	281	99%
Alteon	5-Oct-00	Stock	8,054	391	403	6,705	7,499	93%
Sonoma	19-Oct-00	Stock	462	28	26	411	465	101%

What is the VALUE of an intangible?



Nortel: Acquisition Composition... ©2000

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Nortel: Acquisition Composition... ©2000

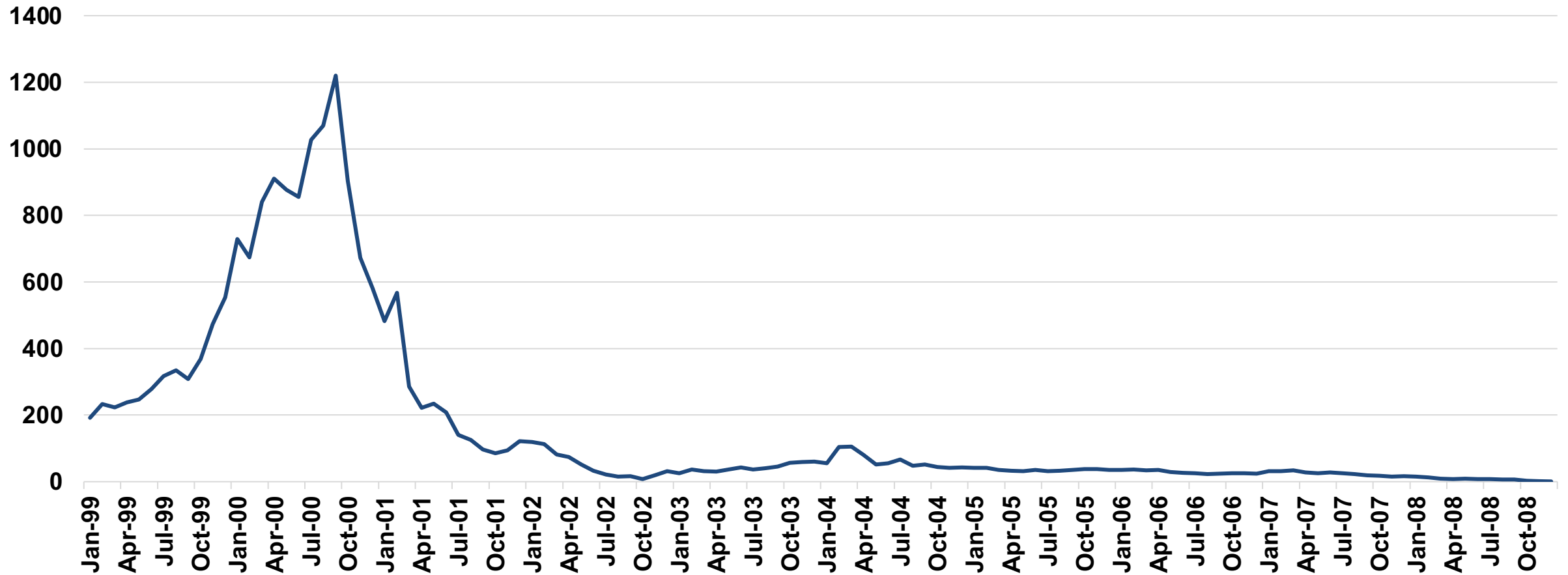
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Nortel Stock Price 1999-2008



Nortel 2000 \$200 B = 2023 \$328 B; Today RBC \$185 B...

Source: Refinitiv. Stock price adjusted for all stock splits



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Bombardier: The Conglomerate Accounting Story...@2001

The Interest Allocation Shuffle

(In millions of Canadian dollars)

	F - 2001	F - 2000	F - 1999	F - 1998
Interest allocated to segments ex-BC	229.5	224.3	150.0	161.4
BC interest expense	499.0	300.2	185.9	112.2
Total allocated interest costs	728.5	524.5	335.9	273.6
Interest income (transportation)	(164.9)	(177.7)	(108.2)	(59.2)
Total Interest Expense Reported	563.6	346.8	227.7	214.4
Cash interest paid for the period	582.2	344.8	288.2	230.7

Imputing interest income is not cash collected

Source: Bombardier public filings, Veritas calculations



Bombardier: Segmented Accounting...©2001

Bombardier's Railcar Division Segmented Results

(In millions of Canadian dollars)

	H1- 2002	F - 2001	F-2000	F-1999	F-1998
Revenues	2,453.4	3,043.3	3,446.1	2,966.3	1,688.1
Cost of sales & operating costs	2,382.1	3,027.3	3,376.6	2,848.8	1,618.3
Depreciation and amortization	47.7	60.4	72.8	77.8	44.4
Interest income	(80.6)	(164.9)	(177.7)	(108.2)	(59.2)
Income before taxes & "special items"	104.2	120.5	174.4	147.9	84.6
Operating margin*	0.96%	1.46%	0.10%	1.33%	1.50%
EBIT margin**	4.20%	3.96%	5.06%	5.00%	5.00%

* Operating margin is calculated as revenue less cost of sales and operating costs and depreciation and amortization over revenue.

** EBIT margin: Defined by Bombardier as the ratio of income before taxes and special items over revenue.

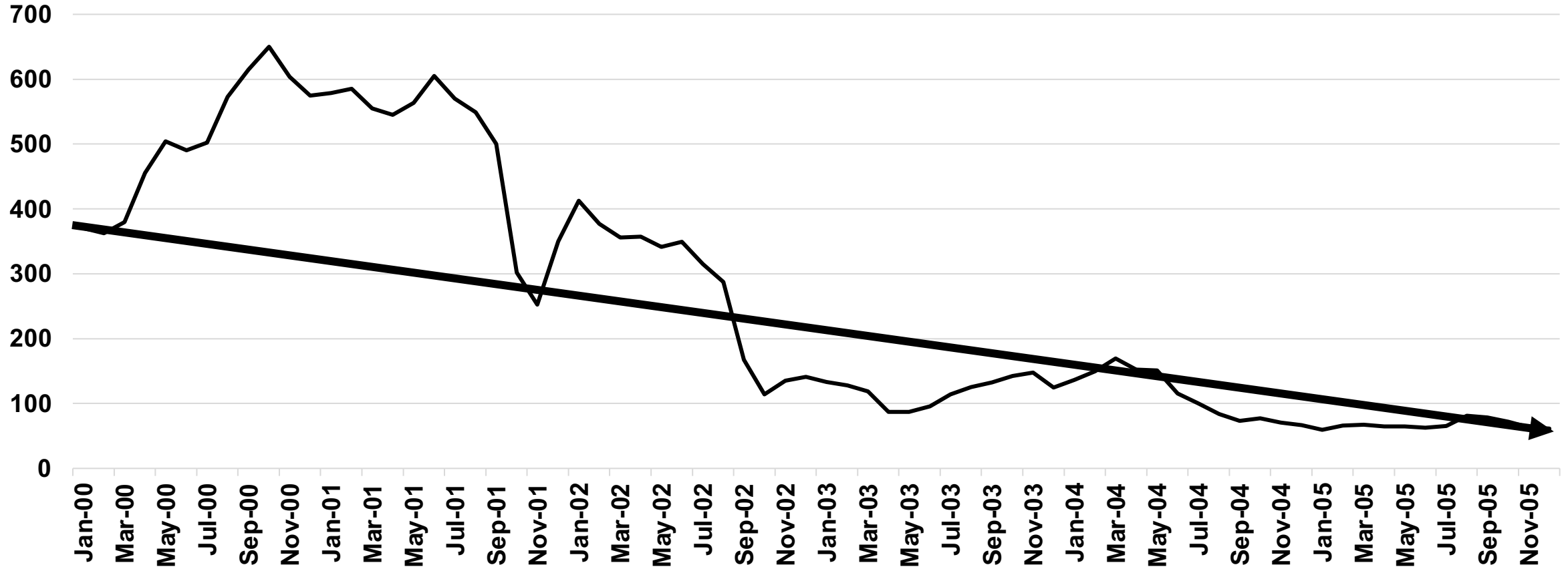
Source: Bombardier public filings, Veritas calculations.

Interest income is an "operating item"...



BOMBARDIER

BBD.b Stock Price History 2000-2005



Dropped 84% in this time period

Source: Refinitiv. Adjusted for all stock splits



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BIOVAIL: The R&D Accounting Story...©2002

Step 1: Set up Intelligent Polymers Limited (IPL) in Bermuda

Step 2: Capitalize IPL through an IPO

Step 3: Conduct R&D on behalf of IPL

Step 4: Buy back product rights when complete to make investors whole

Revenue and Expenditures Related to IPL Development Contract

(Amounts in millions of U.S. dollars)

	1999	1998	1997
Revenue	33.0	9.7	9.6
Expenses	19.8	6.6	4.2
Net Margin	13.2	3.1	5.4

Converting R&D expense into income.



Biovail: Off-Balance Sheet R&D...©2002

Off-Balance Sheet R&D Impact on EBITDA

(Amounts in millions of U.S. dollars)

1999	With IPL	Without IPL	Boost
Revenue	176.5	143.5*	33.0
Expenses**	87.6	87.6	0.0
EBITDA	88.9	55.9	59%

* Reported revenue less IPL revenue 176.5 - 33.0 =143.5

** Reported expenses of \$97.8M reduced by \$10M related to associated depreciation and amortization.

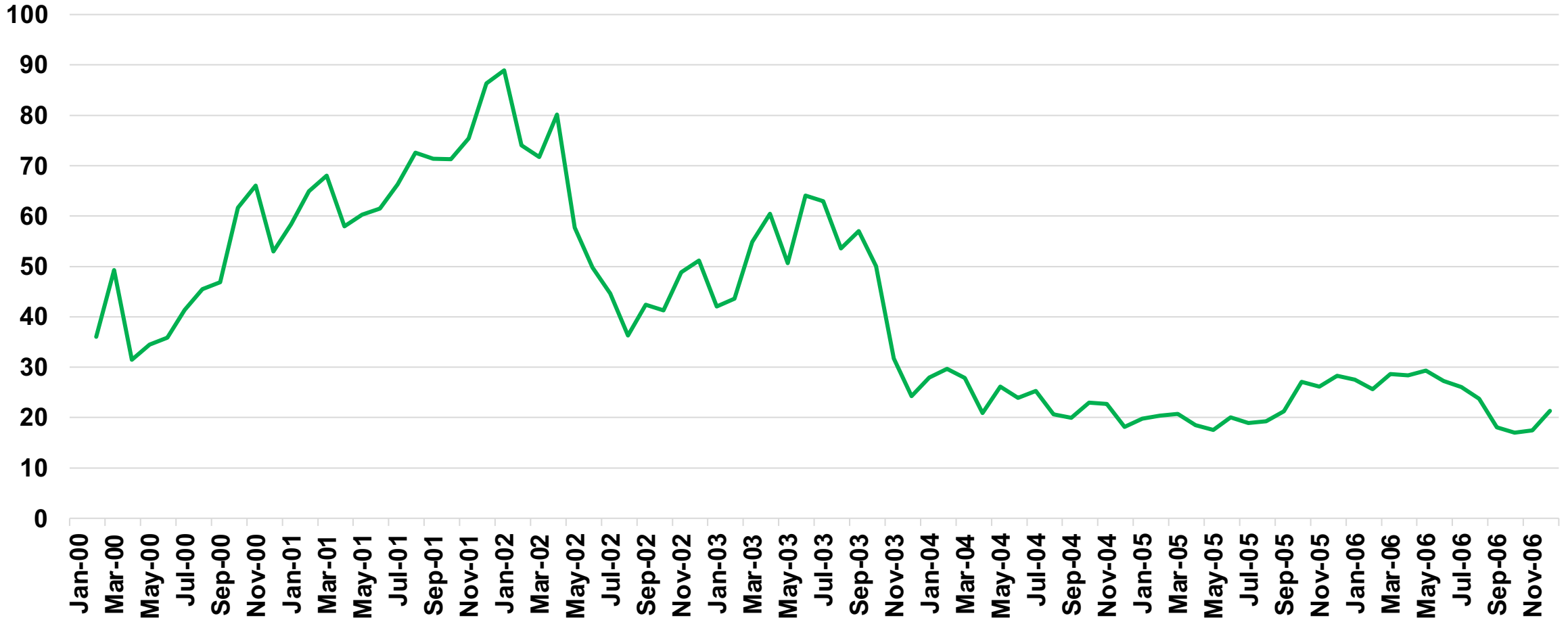
Meanwhile...Biovail completed a common share offering for gross proceeds of \$259 million

R&D changes from a cost center to a profit center...





Biovail Stock Price 2000-2006



Dropped 81% Peak to Trough in this time period

Source: Refinitiv



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Yellow Pages Group: Failing Business Accounting Story...© 2007

Total Pages Published

Metropolitan Area	Region	Month Published	Impact of 2006 Decline on Revenues in	2006	2005	2004	% Decline	
							2006	2005
Toronto Total			2007	2,321	2,542	2,626	(8.7%)	(3.2%)
Montreal	West	March 2006	2007	731	775	739	(5.7%)	4.9%
Victoria		February 2006	2007	1,056	1,203	N.A.	(12.2%)	N/A

Often simple answers solve complex problems

Source: Veritas Investment Research



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Yellow Pages Group: What Drives Revenues...©2007

Display Advertisement Trends –Toronto (E&W), Montreal (W) and Victoria

Size of Advertisement	2006 Publication Impact on Revenues	Published in 2006	Published in 2005	Change
Full page	2007	663	829	(20.0%)
Half page	2007	828	921	(10.1%)
Quarter page	2007	2,177	2,409	(9.6%)
Less than quarter page	2007	10,864	11,887	(8.6%)
Total display		14,532	16,046	(9.4%)

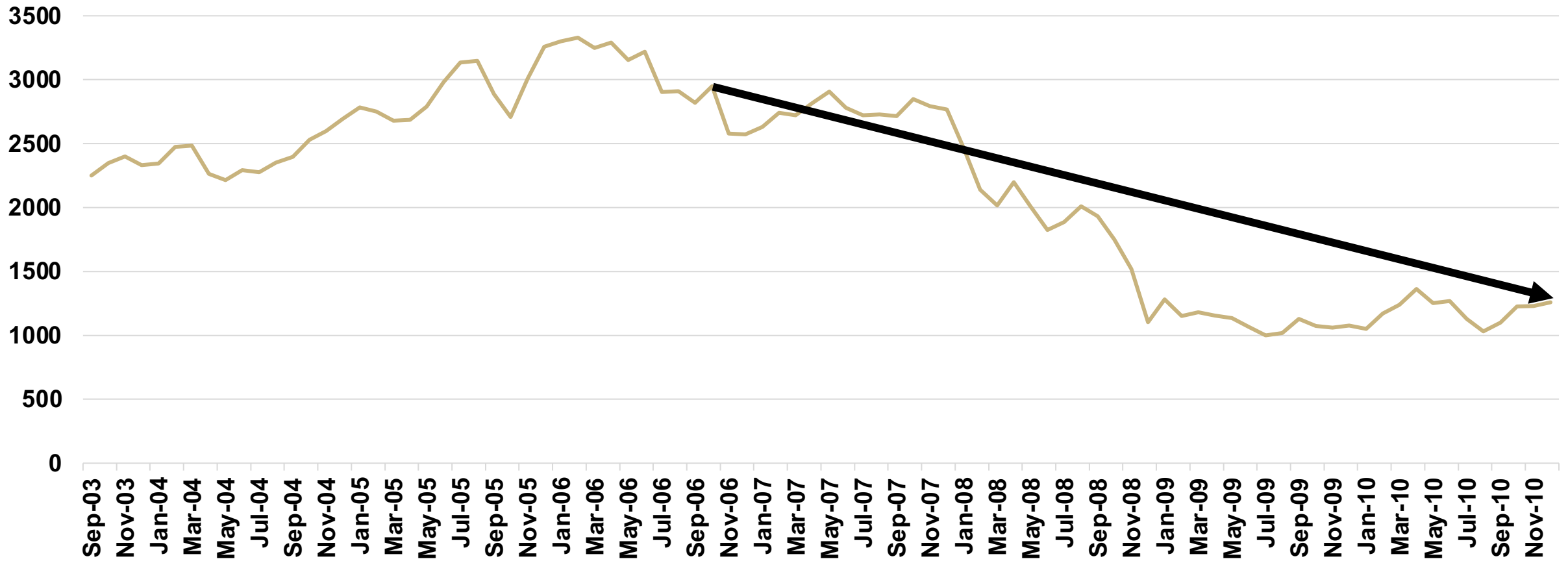
Digging a little deeper – actual ads published

Source: Veritas Investment Research



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YPG Stock Price History 2003-2010



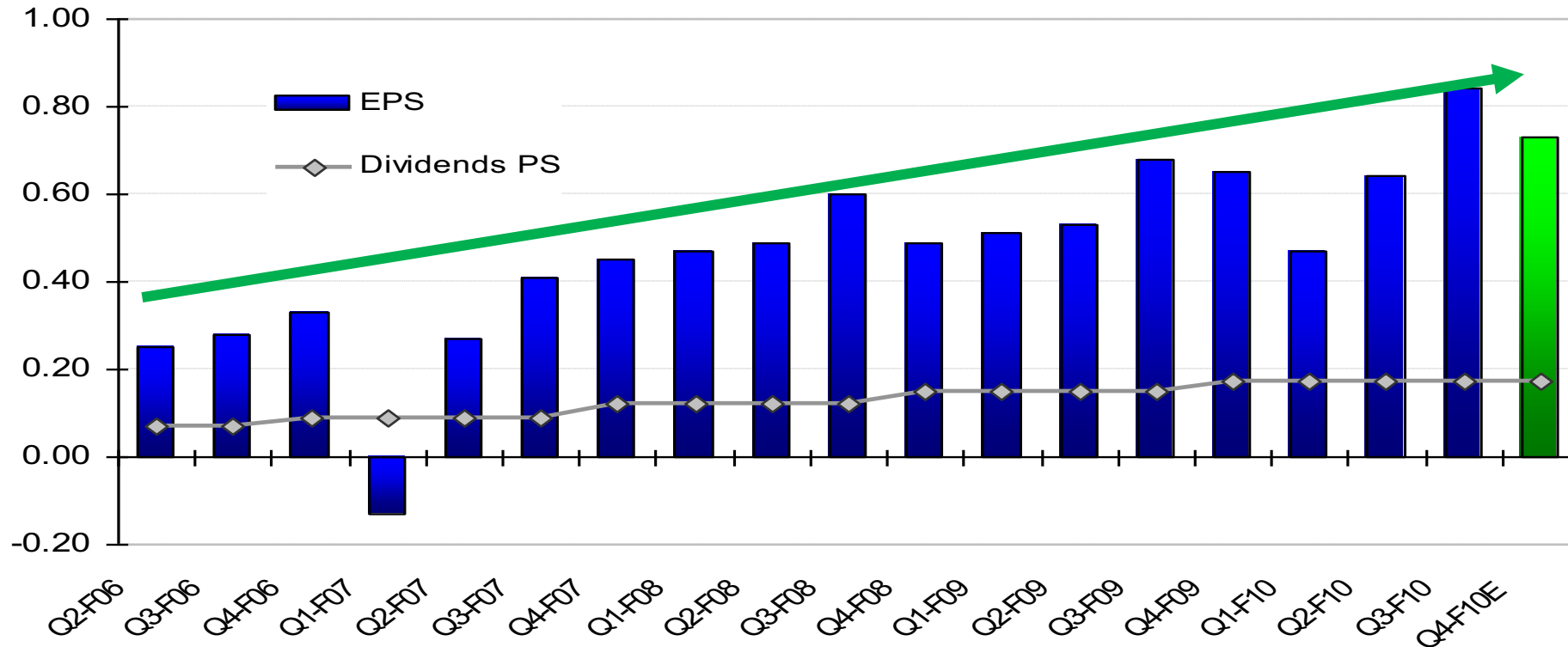
Dropped 60% in this time period

Source: Google Finance. Stock price adjusted for share consolidations



SNC: An Accounting Story... ©2011

Dividends and EPS - 4-Year History & F10 Consensus Estimates



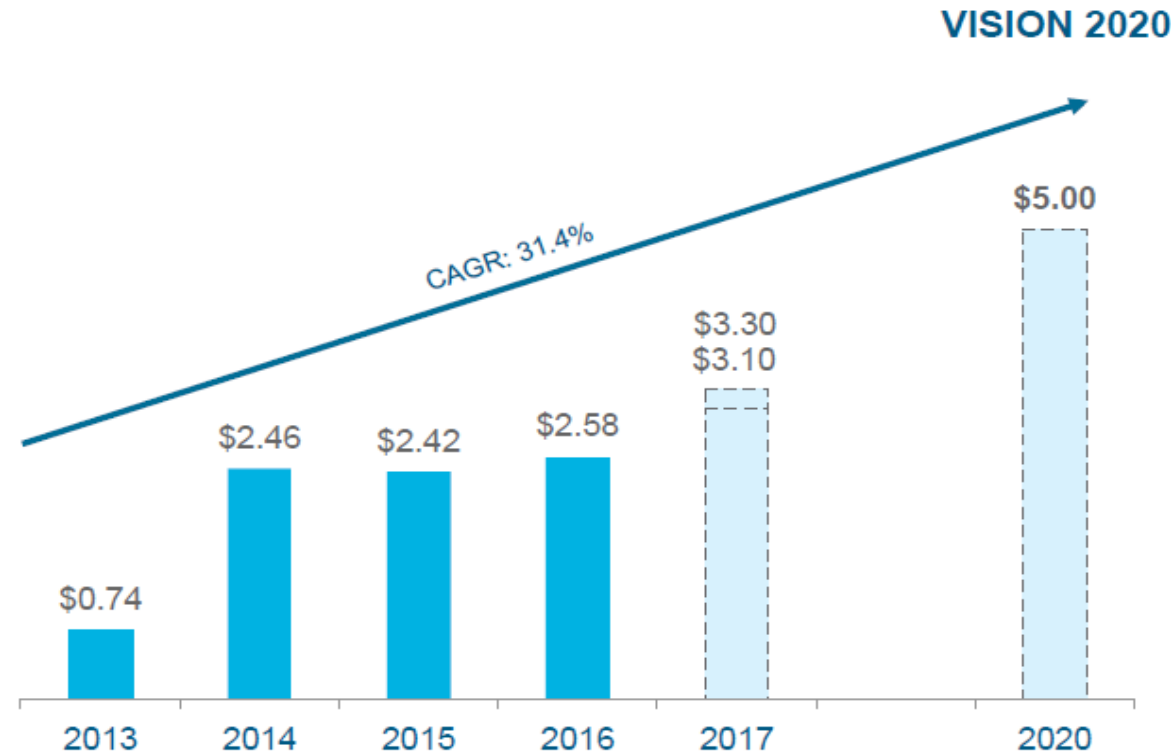
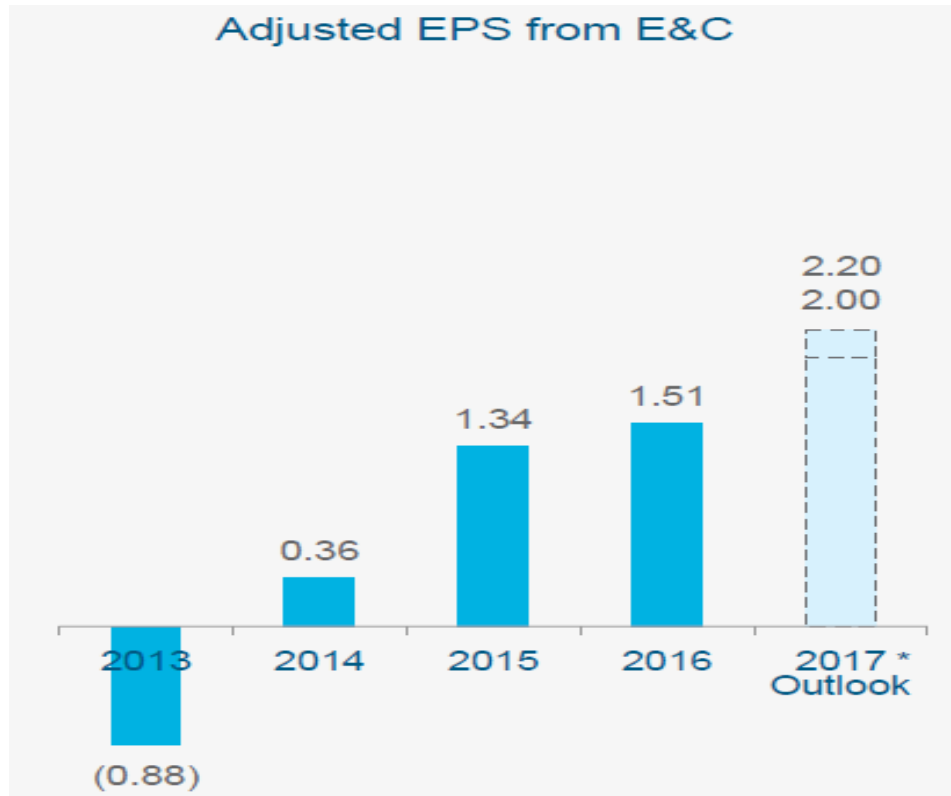
Source of estimates: Reuters

Smooth performance in a volatile sector...



SNC: Expectations Were Great... ©2016

Market needed a new 'story'...



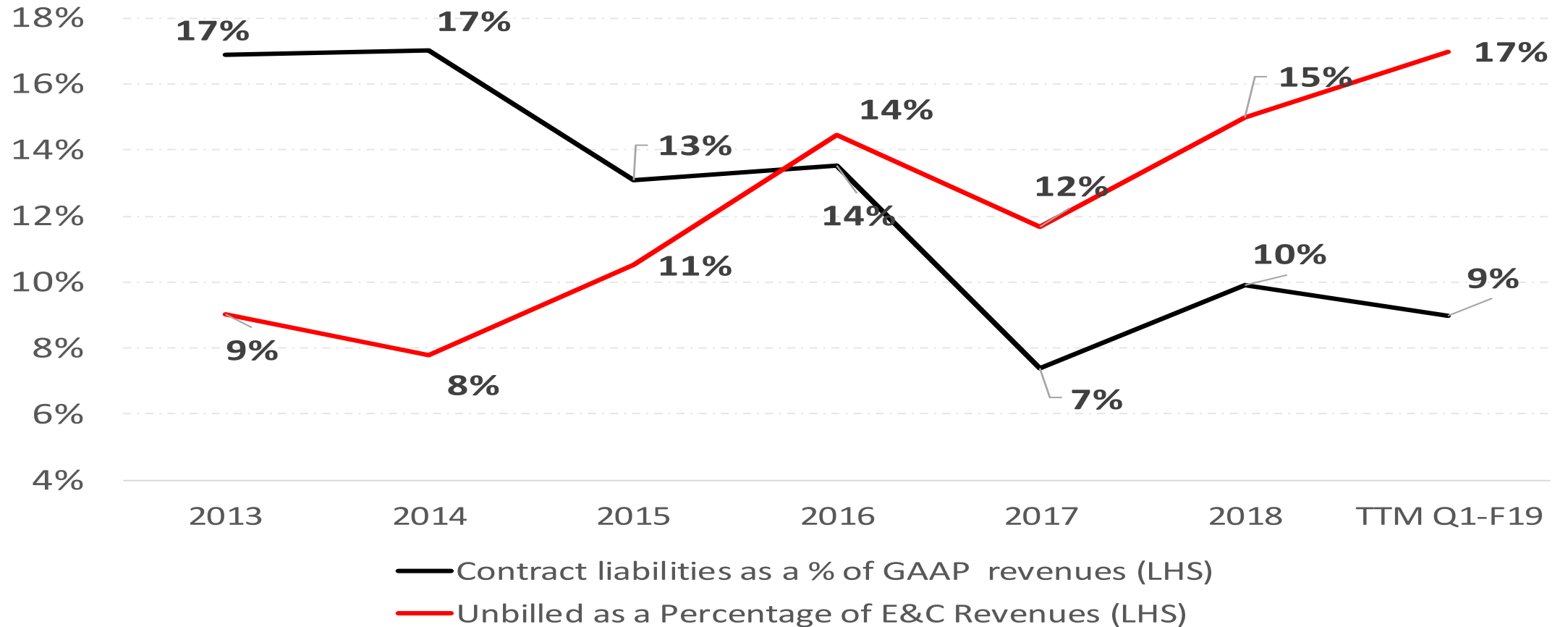
EPS was expected to double by 2020

Source: 2017 Investor Presentation



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SNC: Percentage of Completion Accounting... © 2019



DANGER = The greater the divergence between cash and accrual accounting.

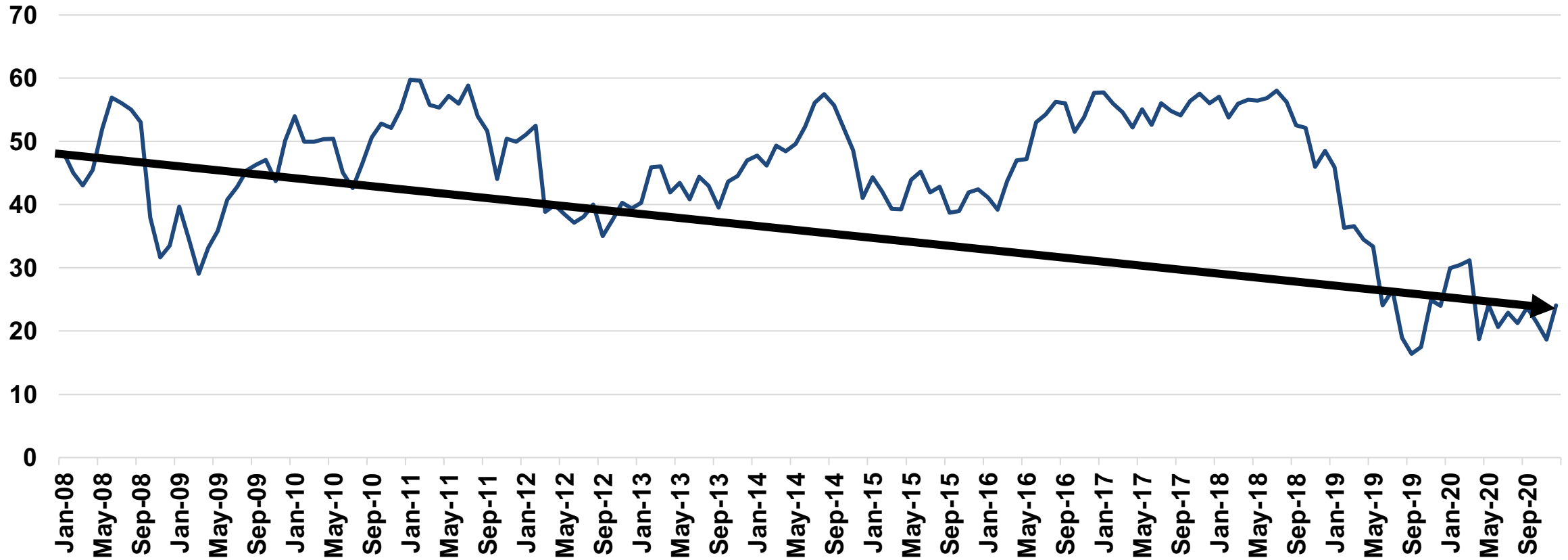
Source: SNC public filings and Veritas calculations.





SNC • LAVALIN

SNC Stock Price History 2008-2020



Dropped 50% in this time period

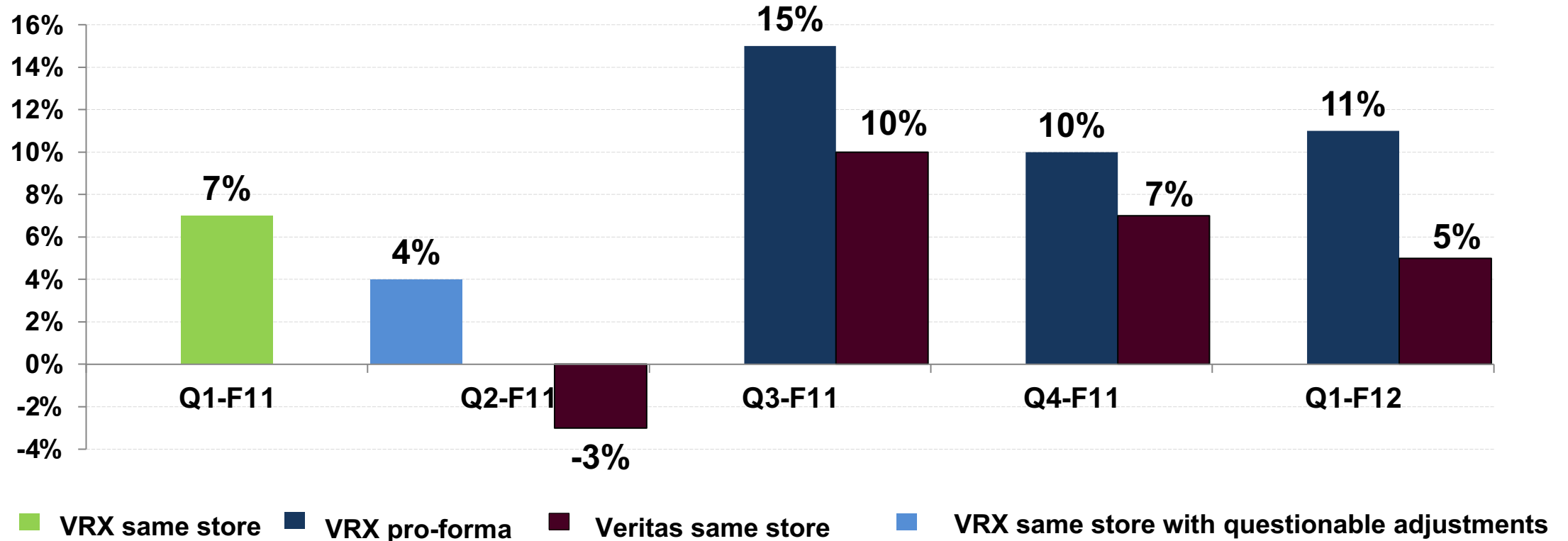
Source: Refinitiv



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Valeant Pharmaceuticals: A Fraud Accounting Story...©2012

Organic Revenue Growth - Evolution



Organic Growth calculation changed three times in three quarters



Valeant: Change in Accounting Policy...© 2013

- Q4-F12: Medicis acquired for \$2.6B
- Q1-F13: Change revenue recognition (Not disclosed)

Accounting Change Boosts Cash Earnings

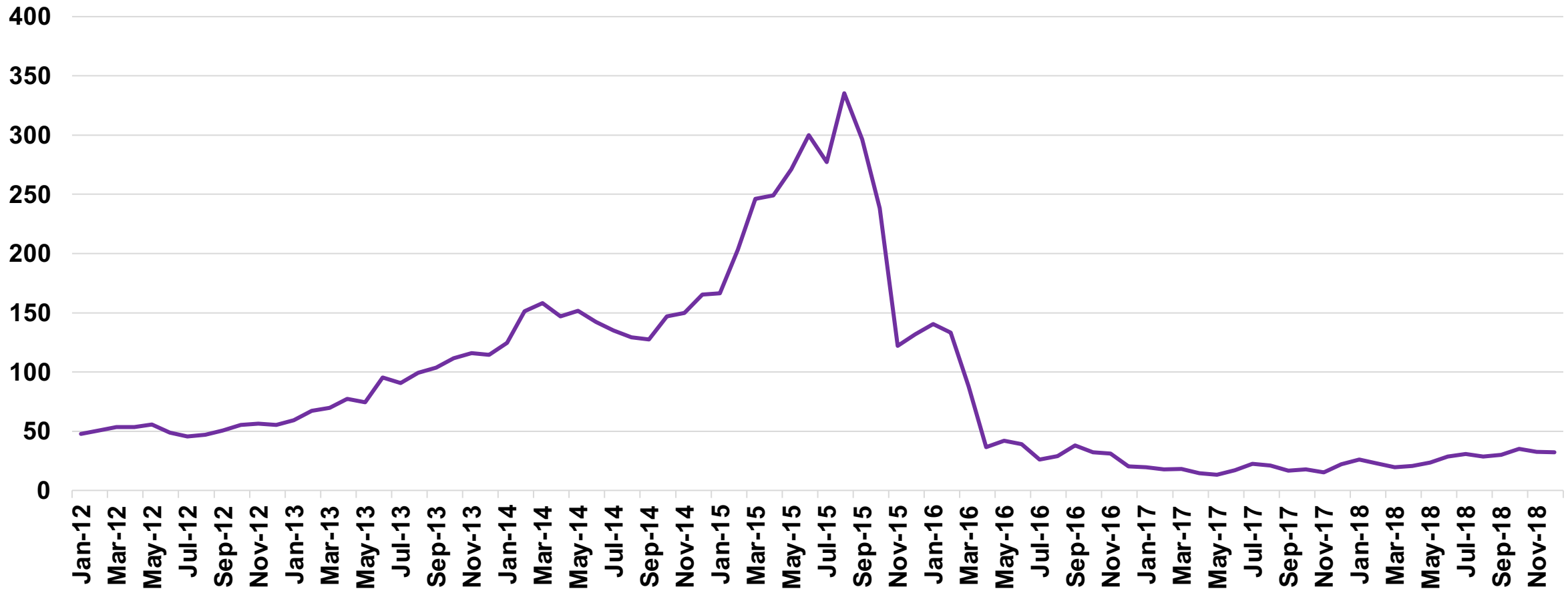
(In millions of US dollars)

	Q1-F13	Q1-F12	% Increase
Cash Earnings-reported	405	360	12%
Est. impact of actg. change	(35)		
Cash Earnings - adjusted	370	360	3%

Change accounting treatment after the acquisition...



Valeant Stock Price 2012-2018



Dropped 96% Peak to Trough in this time period

Source: Refinitiv



LightSpeed: An Impairment Accounting Story...@2021

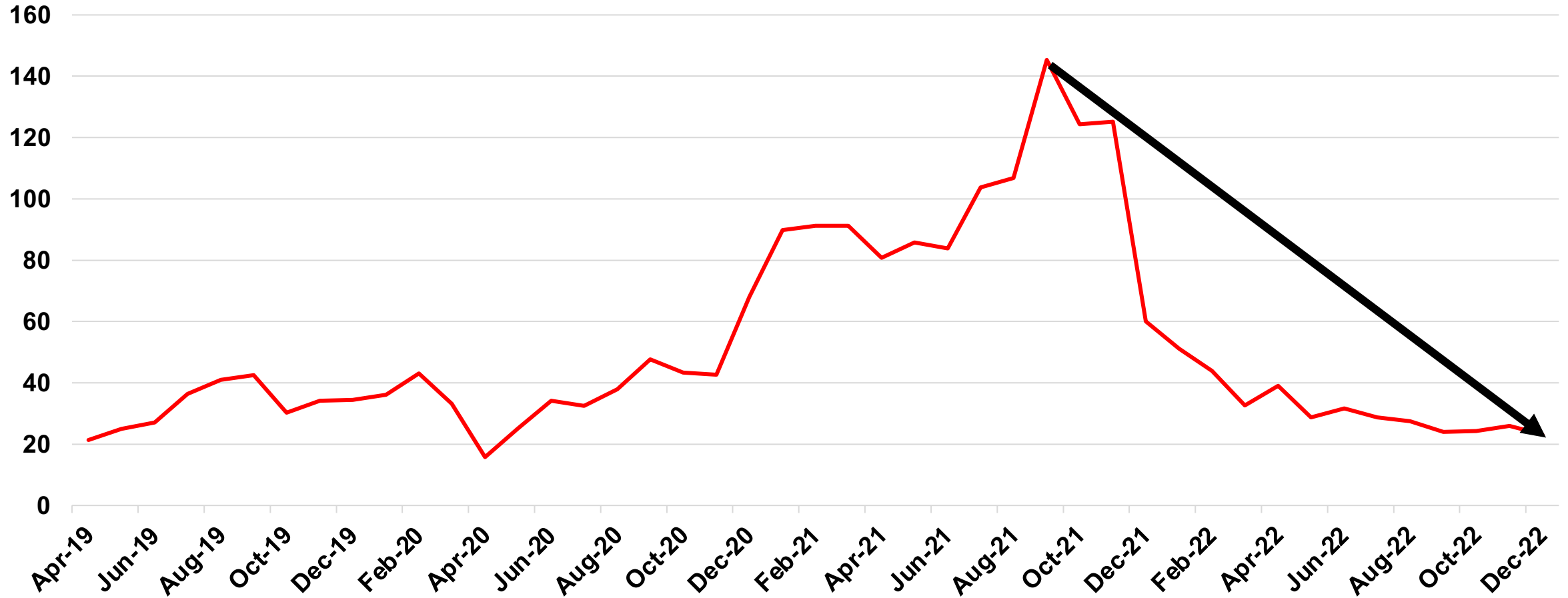
Impairment Analysis	F21	F20	F19	F18
Valuation Method	DCF	DCF	DCF	DCF
Valuation Metrics	Adjusted EBITDA	Adjusted EBITDA	Adjusted EBITDA	Adjusted EBITDA
Forecasts	5 years	5 years	5 years	5 years
Assumptions:				
Pre-tax discount rate	30%	28%	25%	25%
Perpetual growth rate (<u>EBITDA</u>)	35%	30%	30%	30%
Terminal Valuation Multiple (to <u>Revenue</u>)	14x	4x	n.d.	n.d.
Cost of Sale	2.5% of FV	2.5% of FV	2.5% of FV	n.d.
Impairment Recognized?	No	No	No	No

REALISTIC Changes? - Perpetual growth rate expanded from 30-35% as terminal multiple from 4x to 14x

Source: Company Reports and Veritas



LSPD Stock Price History 2019-2022



Dropped 84% Peak to Trough in this time period

Source: Refinitiv



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Flammable Items: Watch List

1. Changes in Financial Communication
2. Changes in Internal Control Structure/Dynamics
3. Changes in non-GAAP Metrics
4. Changes in Accounting Assumptions/Estimates
5. Changes in Economic or Competitive Dynamics
6. Unusual Divergence Between Financial and Operational performance
7. Unusual Divergence in Business Strategy

Existence is more important than Size



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