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Intelligent Money

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Special Notes of Interest:

- Corporate earnings results are generally announced 5 to 8 weeks after the end of the effective quarter. The period of April 14th through April 25th will be the peak announcement period for 1st quarter 2003.
- The 100 biggest corporate pension plans have fallen into a deficit of $157 billion from a surplus of $183 billion in 2000 according to Milliman USA

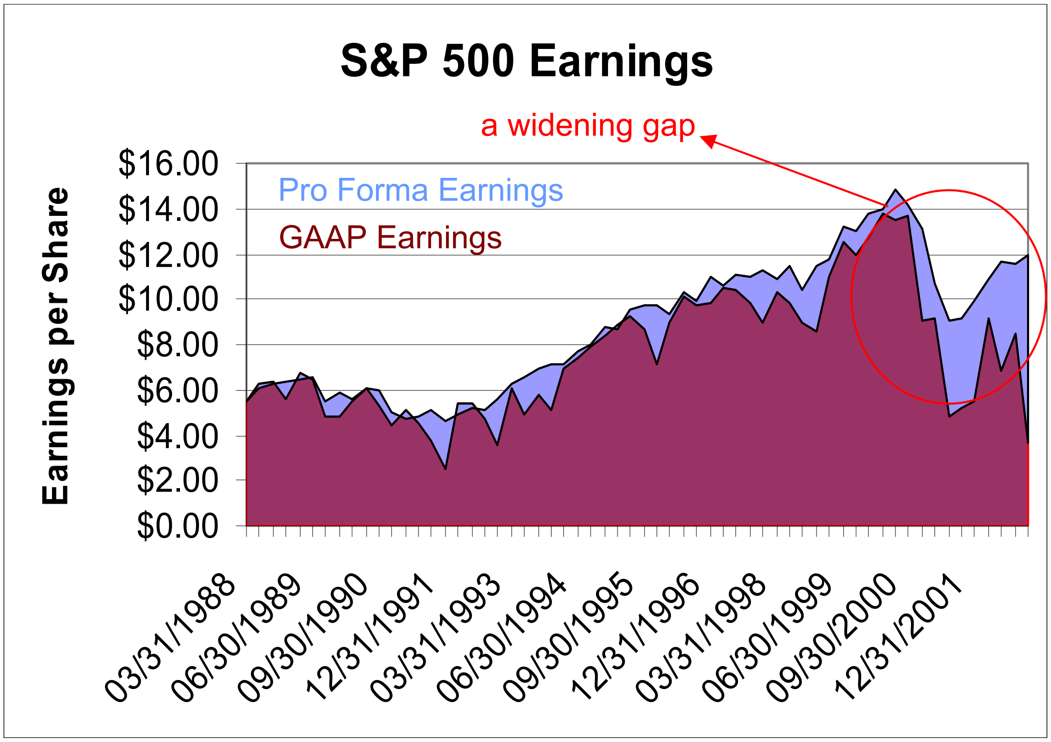
Current thinking from Haven Financial Advisors

Lies, Damn Lies, and Corporate Earnings

The bear market has caused many to revisit some basic assumptions about valuation. Earnings figure prominently in any valuation paradigm. One emerging news story from the wreckage of the new economy is the growing disparity between reported or GAAP earnings and "pro forma" or operating earnings results. Pro forma earnings are represented by public companies as better measures of ongoing business operations

There has been a consensus that adjusting GAAP earnings to exclude nonrecurring and nonoperating items provides a more reliable snapshot of financial health. Yet the Financial Accounting Standards Board (FASB) has not issued a definition of what these adjustments could be. The bull market of the 1990s placed high expectations on the earnings reports of public companies as they struggled ever harder to sustain the stratospheric valuations. Many sought to exclude the huge amortization charges that followed feverish merger activity.

Consequently, the gap between pro forma and GAAP earnings widened considerably over the past four years. At the end of 2002, aggregate pro forma earnings for the S&P 500 were more than 60% higher than GAAP results. The chart below illustrates the widening perception gap. No wonder analysts can't agree on whether the market is rich or cheap!



Corporate Earnings (continued)

Prior to the passage of the Sarbanes-Oxley act in July 2002, companies were not required to reconcile their announced pro forma earnings with GAAP until their 10-Q form was filed. Current law requires reconciliation at the . Despite the new requirement, the gap has widened.

The current economic environment accounts in part for the difference. Companies have routinely excluded asset sales and write-offs from their operating earnings. Losses on hedging activities and pension plans have also been deemed non-core activities. Often the treatment of these events is asymmetric in that positive results are retained in operating earnings while similar setbacks are excluded.

In an attempt to infuse a standard measure to pro forma reporting, Standard & Poors has begun restating corporate financial reporting with a view toward producing "core earnings". The new measure would factor in only those items that reflect ongoing business activity. Like pro forma earnings, the measure will deviate from GAAP. Unlike pro forma earnings, the methodology will be public record and consistently applied to all companies. The goal is to restate corporate earnings at least as far back as 1996. So far, "core earnings" have been restated back to the 1st quarter of 2001.

While the criteria for the "core" calculation remain somewhat in flux, the existing restatements of Standard & Poors paint a more skeptical picture of corporate earnings than either GAAP or pro forma data. Notably, core earnings reflects the cost of employer stock option issuance while a majority of companies still elect to omit options costs from their balance sheets

The following table lists quarterly earnings per share (EPS) results for the S&P based on the three major earnings reporting methodologies. Note that the observed price/earnings ratio of the market varies considerably with the measure for earnings employed as the denominator.

Quarter Ending	Pro Forma EPS	GAAP EPS	Core EPS
12/31/2002	11.92	3.64	6.11
09/30/2002	11.61	8.53	5.85
06/30/2002	11.64	6.87	5.40
03/31/2002	10.85	9.19	6.62
12/31/2001	9.94	5.45	2.92
09/30/2001	9.16	5.23	3.55
06/30/2001	9.02	4.83	4.15
03/31/2001	10.73	9.18	6.15

S&P 500	893.58	893.58	893.58
12 months EPS	46.02	28.23	23.98
P/E	19.42	31.65	37.27

Analysts have long debated the utility of value based measures in the stock market. Now, however, there is very public disagreement as to what constitutes ongoing economic gain. The argument has spilled out of the academic halls into the public arena. As the table illustrates, revised measures of earnings undertaken by Standard & Poors reveal a stock market that is richly valued despite its swift and substantial decline.

The foregoing story is not an argument to sell stocks. It is instead a caution to anyone facing a buying or selling "opportunity". In an environment with huge inventories of useless equipment and goodwill, all is not what is seems. The only real financial opportunity is one borne of a sound long-term financial plan.

Standard & Poors maintains a website where updates to its computational methodology and earnings data reside. By years end it expects to have restated corporate earnings back to 1996, the first year that FASB required option expenses to be disclosed. The site is located at

www.coreearnings.standardandpoors.com

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