An Accounting Lesson for Twitter

By Jonathan Weil - Oct 4, 2013

Whether he prevails at his insider-trading trial or winds up paying a fine to the Securities and Exchange Commission, Mark Cuban, owner of the Dallas Mavericks, performed a mitzvah during his testimony this week when he plainly described to the jury what “Ebitda” is.

“It's a term companies use when they want to make it seem like they're doing better than they are," he said of the oft-cited financial metric, which stands for earnings before interest, taxes, depreciation and amortization. Nice timing, too. Cuban said it right before Twitter Inc. filed the registration statement for its initial public offering.

Ebitda doesn’t exclude enough expenses for Twitter’s liking. So it highlights “adjusted Ebitda,” which excludes expenses for stock-based compensation, as well. For 2012, the microblogging service said it had a net loss of $79.4 million, using generally accepted accounting principles, or GAAP. By comparison, its adjusted Ebitda was $21.2 million, which indeed looks much better.

Likewise, for the six months that ended June 30, Twitter reported a net loss of $69.3 million. Its adjusted Ebitda was $21.4 million. Twitter also cited something that it called “non-GAAP net loss,” which is just another made-up earnings metric that doesn't comply with GAAP. This one looks better than the company’s actual net loss, but not as good as adjusted Ebitda.

The Securities and Exchange Commission’s rules for non-standard financial metrics say that companies must provide “a statement disclosing the reasons why the registrant’s management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations."

Twitter tried, but its explanation wasn't very convincing. Here's an excerpt: "We believe that adjusted Ebitda and non-GAAP net loss help identify underlying trends in our business that could otherwise be masked by the effect of the expenses that we exclude in adjusted Ebitda and non-GAAP net loss." It didn't say what such trends might be or explain how including such expenses could render them invisible. Obviously, the real reason Twitter cites these baloney numbers is the one that Mark Cuban gave.

Other companies have engaged in far worse non-GAAP abuses. Groupon Inc., the online coupon distributor, invented a ridiculous financial metric before its IPO called "adjusted consolidated segment operating income," which conveniently excluded most of its operating expenses.

I have never understood why companies believe it's a good idea to do this. Highlighting pretend earnings figures shouldn't add a dime to the company's market value. Sophisticated investors see right through the nonsense. Unsophisticated investors probably won't read the financials anyway. Nobody is deciding to buy Twitter's stock because of its recent bottom line. They will buy it because Twitter is a global phenomenon with great potential.

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