Allergan's "Bold, Imaginative" Non-GAAP Accounting Raises Red Flags

Summary

- Last year the SEC issued guidance on impermissible non-GAAP financial metrics.
- Allergan's "non-GAAP EPS" measure appears to violate these rules.
- Allergan will likely need to cease using (or substantial alter) its "non-GAAP EPS" metric.

"Today, under one company name and identity, we set out on a new path forward, encouraging our employees across the globe to **be bold in how we think and act**."

--Allergan CEO, announcing the merger of Actavis and Allergan in June 2015 (emphasis added)

Allergan (NYSE:AGN) may soon find itself facing questions from the SEC regarding the company's most-touted (among investors and analysts) measures included in its earnings releases and financial guidance: its "non-GAAP EPS" metric. In this article we first examine the SEC rules and guidance governing non-GAAP disclosures and second determine whether Allergan is in compliance (in form and spirit) with such rules and guidance. A thorough review leads to the inevitable conclusion that Allergan is not in compliance.

"BOLD, IMAGINATIVE ACCOUNTING"

In his 1998 letter to Berkshire Hathaway shareholders, Warren Buffett had the following choice words regarding the accounting gimmicks that management teams play from time to time:

> It was once relatively easy to tell the good guys in accounting from the bad: The late 1960's, for example, brought on an orgy of what one charlatan dubbed "bold, imaginative accounting" (the practice of which, incidentally, made him loved for a time by Wall Street because he never missed expectations). But most investors of that period knew who was playing games. And, to their credit, virtually all of America's most-admired companies then shunned deception.
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> In recent years, probity has eroded. Many major corporations still play things straight, but a significant and growing number of otherwise high-grade managers--CEOs you would be happy to have as spouses for your children or as trustees under your will--have come to the view that it's okay to manipulate earnings to satisfy what they believe are Wall Street's desires. Indeed, many CEOs think this kind of manipulation is not only okay, but actually their *duty*. [emphasis in original]

The more things change, the more they stay the same. Just last year in his 2015 shareholder letter, Buffett felt compelled to reiterate warnings similar to those he had issued almost two decades ago regarding the (mis)use of non-GAAP financial metrics:

> I suggest that you ignore a portion of GAAP amortization costs. But it is with some trepidation that I do that, knowing that it has become common for managers

> to tell their owners to ignore certain expense items that are all too real. "Stock-based compensation" is the most egregious example. The very name says it all: "compensation." If compensation isn't an expense, what is it? And, if real and recurring expenses don't belong in the calculation of earnings, where in the world do they belong?
>
> Wall Street analysts often play their part in this charade, too, parroting the phony, compensation-ignoring "earnings" figures fed them by managements. Maybe the offending analysts don't know any better. Or maybe they fear losing "access" to management. Or maybe they are cynical, telling themselves that since everyone else is playing the game, why shouldn't they go along with it. Whatever their reasoning, these analysts are guilty of propagating misleading numbers that can deceive investors.
>
> Depreciation charges are a more complicated subject but are almost always true costs. Certainly they are at Berkshire. *I wish we could keep our businesses competitive while spending less than our depreciation charge, but in 51 years I've yet to figure out how to do so.* Indeed, the depreciation charge we record in our railroad business falls far short of the capital outlays needed to merely keep the railroad running properly, a mismatch that leads to GAAP earnings that are higher than true economic earnings.... When CEOs or investment bankers tout pre-depreciation figures such as EBITDA as a valuation guide, watch their noses lengthen while they speak. [emphasis added]

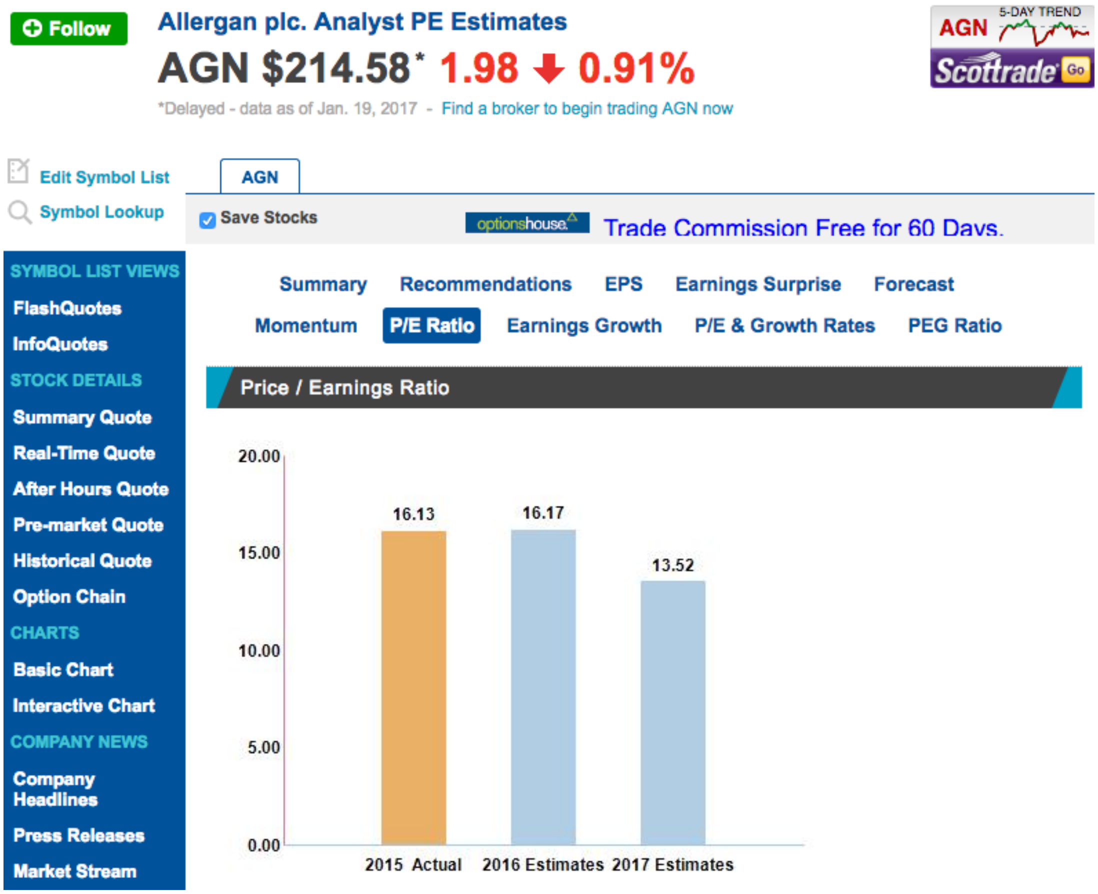
Carl Icahn, a former Allergan shareholder (ironically) who divested his Allergan shares after just a six-month hold in late 2016, appears to agree with Buffett, stating the following shortly after Buffett's public admonitions:

> The [non-GAAP] earnings [companies] are putting out today, I think, they are very suspect. You have not really increased earnings for three years. GAAP earnings for the S&P 500 have stayed at around $100 a share for three years.

ALLERGAN'S "NON-GAAP EPS" METRIC

Allergan employs a metric called "non-GAAP EPS" in its financial reporting and guidance (note: Allergan sometimes refers to this metric as "non-GAAP earnings per share"; for brevity, we will just use the shorter term herein). For fiscal 2016 Allergan has provided guidance for non-GAAP EPS of between $13.30 and $13.50 per share (source: Q3 2016 earnings release). At the midpoint of $13.40, Allergan thus trades at a trailing P/E multiple of around 16X, which appears on its face to be quite reasonable in comparison to the trailing 21X and forward 17X multiples of the S&P 500 (source: Factset Earnings Insight, January 13, 2017). Analysts expect Allergan's non-GAAP EPS to rise to nearly $16/share in fiscal 2017 (source), which would represent growth of 19% over 2016. Thus Allergan has a forward estimated P/E multiple of 13.5X, which seems downright cheap for 19% earnings growth.

Clearly most investors, analysts and the financial press have bought into the notion that Allergan's non-GAAP EPS metric accurately reflects the company's true economic earnings (if fact, in many instances they don't even mention that it is a non-GAAP metric). Here are just a few examples of this unquestioning acceptance:



([source](#))

Allergan issues 2017 guidance, expects double-digit EPS growth

Published: Jan 5, 2017 8:57 a.m. ET

By CAITLIN HUSTON
REPORTER

Aa

Allergan PLC **AGN, -0.91%** issued 2017 guidance Thursday saying that the company expects to deliver non-GAAP mid-single-digit top-line net revenue growth. The growth is assumed based on stable net revenue for Restasis, a medication for chronic dry eye and a combination of the launch of Namenda XR, an Alzheimer's medication, in the fourth quarter of 2017, offset by strong performance from Namzaric, another Alzheimer's medication. It does not including the company's acquisition of Lifecell. Allergan said it expects to reach double-digit non-GAAP earnings per share growth in 2017. Analysts surveyed by FactSet expected earnings per share of $16.08 and sales of $15.3 billion for 2017. Shares of Allergan were up less than 1% Thursday morning. Shares of Allergan have gained 13% in the past month compared to the S&P 500's gain of 3%.

([source](#))

ALLISON GATLIN | 1/05/2017 Reprints

Allergan (AGN) stock popped to an eight-week high Thursday after the drugmaker issued 2017 guidance in line with broader Wall Street expectations.

In afternoon trading on the stock market today, Allergan stock lifted 2.4%, near 221. Shares have risen 10 of the past 11 trading days, last week moving above their 50-day moving average and zeroing in on their 200-day average. Allergan stock plummeted 33% in 2016 amid the raucous drug-pricing debate.

For 2017, Allergan sees mid-single-digit non-GAAP top-line net revenue growth and double-digit growth in earnings per share minus items. That compares with the consensus of analysts polled by FactSet for 5.5% sales growth and 20% earnings growth, says Mizuho analyst Irina Koffler.

IBD'S TAKE: *Will your drug stocks survive if Donald Trump breaks with Republicans and seeks to curb rising drug prices?*

Koffler maintained her buy rating and 273 price target on Allergan stock following the announcement. She sees Allergan pulling in 4.3% sales growth and 19.1% EPS minus items growth in 2017.

(source)

On January 5th, Allergan's CEO Brent Saunders took part of Goldman Sachs (NYSE:GS) Healthcare CEO's Unscripted Conference in a fireside chat session. He laid out 2017 and stated, " We look forward to strong execution in 2017 to drive stronger shareholder return in the short - and long - term. Our team remains focused on driving our growth trajectory and we are very excited for the tremendous opportunities ahead".

In a PR release later that day shareholders were given a closer look into 2017. From said release, we were able to learn that Allergan expects to see mid-single-digit top-line revenue growth Y/Y and double-digit EPS growth Y/Y.

(source)

So, on the surface, all looks great: double-digit EPS growth, 16X trailing and 13.5X forward EPS. If all goes accordingly to plan, Allergan could easily be a $300 stock by the end of 2017 (assuming it trades at just under 19X expected $16/share 2017 EPS), representing nearly 40% upside from the current stock price. What's not to like, right?

The only fly in the ointment, however, which hardly anyone appears to have noticed, is that *Allergan's "non-GAAP EPS" metric appears to violate the SEC's rules and guidance governing such measures*.

SEC'S NON-GAAP DISCLOSURE RULES

The general rules regarding non-GAAP disclosures are contained in Part 229.10 of Regulation S-K contained in the Code of Federal Regulations (as adopted pursuant to the passage of Regulation G back in 2003 (Conditions for Use of Non-GAAP Financial Measures), as directed by the Sarbanes-Oxley Act of 2002). The key provisions are contained in paragraph "E" of Part 229.10, as follows:

> Paragraph E. Use of non-GAAP financial measures in Commission filings. (1) Whenever one or more non-GAAP financial measures are included in a filing with the Commission:
>
> i. The registrant must include the following in the filing:
>
> A. A presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with Generally Accepted Accounting Principles (GAAP);
>
> B. A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP identified in paragraph E.1.I.A. of this section;
>
> C. 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; and
>
> D. To the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not disclosed pursuant to paragraph 1.C. of this section; and
>
> ii. A registrant must not:
>
> A. Exclude charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation, and amortization (EBITDA);
>
> B. Adjust a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, 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;
>
> C. Present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes;

D. Present non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X (17 CFR 210.11-01 through 210.11-03); or

E. Use titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

Due to the increasing abuse of non-GAAP financials by public companies generally in recent years, the SEC in May 2016 updated its non-GAAP compliance guidelines in order to cut down on investor deception. Most importantly for our purposes is Question 102.05 and its answer:

Question 102.05

Question: While Item 10(1)(ii) of Regulation S-K does not prohibit the use of per share non-GAAP financial measures, the adopting release for Item 10, Exchange Act Release No. 47226, states that "per share measures that are prohibited specifically under GAAP or Commission rules continue to be prohibited in materials filed with or furnished to the Commission." In light of Commission guidance, specifically Accounting Series Release No. 142, *Reporting Cash Flow and Other Related Data*, and Accounting Standards Codification 230, are non-GAAP earnings per share numbers prohibited in documents filed or furnished with the Commission?

Answer: No. Item 10 recognizes that certain non-GAAP per share performance measures may be meaningful from an operating standpoint. Non-GAAP per share performance measures should be reconciled to GAAP earnings per share. ***On the other hand, non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis in documents filed or furnished with the Commission, consistent with Accounting Series Release No. 142. Whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure***. When analyzing these questions, the staff will focus on the substance of the non-GAAP measure and not management's characterization of the measure. [May 17, 2016]

(emphasis added)

IMPERMISSIBILITY UNDER SEC RULES OF ALLERGAN'S "NON-GAAP EPS" METRIC

Obviously, the key question for Allergan to answer (and answer satisfactorily for the SEC) is whether Allergan's current preferred "non-GAAP EPS" metric qualifies as a "non-GAAP liquidity measure that measures cash generated". Below is the reconciliation of this metric for the first 9 months of 2016, per Allergan's Q3 2016 earnings release:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
GAAP to Non-GAAP Adjusted net income calculation				
GAAP (loss) from continuing operations attributable to shareholders	$ (381.9)	$ (876.4)	$ (899.2)	$ (2,155.6)
Adjusted for:				
Amortization	1,609.1	1,557.8	$ 4,831.9	3,858.9
Acquisition and licensing charges (1)	321.5	1,297.7	$ 793.2	3,155.9
Accretion and fair-value adjustments to contingent consideration	15.9	81.3	$ 79.3	87.3
Impairment/asset sales and related costs	37.3	295.6	$ 292.9	500.7
Non-recurring (gain) / losses	18.2	4.5	$ 18.4	42.2
Legal settlements	40.8	17.5	$ 100.0	20.5
Income taxes on items above and other income tax adjustments	(282.2)	(956.7)	$ (1,190.0)	(1,800.3)
Non-GAAP adjusted net income attributable to shareholders	$ 1,378.7	$ 1,421.3	$ 4,026.5	$ 3,709.6
Diluted earnings per share				
Diluted (loss) per share from continuing operations attributable to shareholders- GAAP	$ (0.97)	$ (2.23)	$ (2.28)	$ (6.01)
Non-GAAP adjusted diluted earnings per share attributable to shareholders	$ 3.32	$ 3.41	$ 9.66	$ 9.82
Basic weighted average ordinary shares outstanding	392.7	393.6	394.4	358.9
Effect of dilutive securities:				
Dilutive shares	22.0	22.7	22.3	18.8
Diluted weighted average ordinary shares outstanding	414.7	416.3	416.7	377.7

The first thing we note is the large addbacks for amortization, amounting to almost $5 billion in the first three quarters of 2016. Also catching the eye are nearly $800 million and $300 million, respectively, in addbacks for "acquisition and licensing charges" and asset impairments in the nine months ending September 30, 2016. In total, just these three items, which are presumably virtually all non-cash charges, amount to over $6 billion in supposed "earnings" added back in the non-GAAP EPS calculation, or over $14/share. While admittedly taxes for these "earnings" are deducted, Allergan's non-GAAP alchemy still manages to transform $2.28/share in GAAP losses for the first 9 months of last year into $9.66/share in non-GAAP "earnings" for the same period, a massive $11.94/share spread between the two figures. The prior year same period numbers were even more impressive (or, depending one's viewpoint, disconcerting), as $6.01/share in GAAP losses were magically transformed into $9.82/share in non-GAAP "earnings", an almost $16/share (and $5.98 billion in aggregate) disparity.

To go back to the SEC's published guidance regarding permissible non-GAAP metrics, non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis. So, is Allergan's non-GAAP EPS number a "liquidity measure"? It sure seems to be. First, we note the gigantic disparities between the GAAP and non-GAAP figures, which are plainly obvious. Next we observe that the non-GAAP EPS are much more similar to Allergan's cash flow numbers than to its GAAP earnings numbers. Below are Allergan's EBITDA, adjusted EBITDA and adjusted Operating Numbers, each of which are clearly liquidity (as opposed to income) measurements, also taken from the Q3 2016 earnings release:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
GAAP (loss) from continuing operations attributable to shareholders	$ (381.9)	$ (876.4)	$ (899.2)	$ (2,155.6)
Plus:				
Interest expense	324.3	340.2	1,002.9	852.0
Interest income	(18.1)	(3.5)	(23.5)	(7.6)
(Benefit) for income taxes	(158.9)	(838.9)	(825.8)	(1,491.0)
Depreciation (includes accelerated depreciation)	40.7	37.9	114.5	96.0
Amortization	1,609.1	1,557.8	4,831.9	3,858.9
EBITDA	$ 1,415.2	$ 217.1	$ 4,200.8	$ 1,152.7
Adjusted for:				
Acquisition and licensing and other charges	293.8	1,254.2	704.6	2,706.2
Impairment/asset sales and related costs	37.3	295.6	292.9	500.7
Non-recurring (gain) / losses	18.2	4.5	18.4	42.2
Legal settlements	40.8	17.5	100.0	20.5
Accretion and fair-value adjustments to contingent consideration	15.9	81.3	79.3	87.3
Share-based compensation	81.0	117.0	257.0	625.3
Adjusted EBITDA	$ 1,902.2	$ 1,987.2	$ 5,653.0	$ 5,134.9
Adjusted for:				
Depreciation	(40.7)	(37.9)	(114.5)	(96.0)
Dividend income	(34.1)	-	(34.1)	-
Share-based compensation restructuring charges and purchase accounting impact on stock-based compensation for acquired awards	(43.0)	(54.1)	(127.8)	(124.8)
Adjusted Operating Income	$ 1,784.4	$ 1,895.2	$ 5,376.6	$ 4,914.1

For the first 9 months of 2016, EBITDA was $4.2 billion, adjusted EBITDA was $5.6 billion and adjusted Operating Earnings were $5.4 billion, each as compared with $4.0 adjusted non-GAAP earnings for the same period. These numbers are much more closely clustered together in comparison with the GAAP net loss figure of negative $899 million.

For the first 9 months of 2015, EBITDA was $1.1 billion, adjusted EBITDA was $5.1 billion and adjusted Operating Earnings were $4.9 billion, each as compared with $3.7 billion adjusted non-GAAP earnings for the same period. Again, these numbers are much more closely clustered together in comparison with the GAAP net loss figure of negative $2.2 billion.

One reaches the same conclusion looking just at the third quarter 2016 and 2015 numbers as well. Prima facie, then, it seems that the "non-GAAP EPS" amounts that Allergan presents to the investment community are non-GAAP liquidity metrics, not legitimate non-GAAP net income metrics. *Yet the SEC has stated that non-GAAP liquidity metrics may* ***not*** *be stated on a per share basis, which is exactly what Allergan does in its earnings releases and guidance*. The SEC's reason for prohibiting "per share" non-GAAP liquidity metrics is obvious: they do not want such metrics falsely presented to the public as "earnings" or "EPS", which can (and clearly does) mislead investors and analysts alike.

While the foregoing represents the clearest example of why Allergan's non-GAAP metric seems to violate SEC rules, one can also make the case that Allergan fails to comply with two other provisions cited above, namely the "earnings smoothing" prohibition and the "confusing or similar description" prohibition.

First, the "earnings smoothing prohibition" states that "A registrant must not...[a]djust a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, 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". With respect to Allergan's non-GAAP EPS figures from 2015 and 2016, we note that the company excludes (1) all of its GAAP amortization charges in each period, even though they are recurring and are virtually certain to recur in the future; (2) acquisition and licensing charges even though they are recurring and are highly likely to recur in the future (due to Allergan's "Open Science" model, the company is dependent on acquisitions to sustain its business, since Allergan underinvests in organic R&D compared to peers); and (3) impairments/asset sales even though these costs are recurring due to the nature of Allergan's business model. Allergan even has an add-back category for "Non-recurring gains/losses", which implies that such items are recurring (not non-recurring).

Second, the "confusing or similar description" prohibition states that "A registrant must not...[u]se titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures." As shown above, data providers, investors and analysts alike appear to have wholesale substituted the non-GAAP EPS figure for the GAAP EPS figure, often even omitting to mention the "non-GAAP" part (or referring to EPS "minus items" (note that this should really refer to EPS "excluding items")). On the most recent earnings call for Q3 2016, neither the CEO nor the CFO mentioned the GAAP earnings loss of $1.15/share, solely mentioning that "non-GAAP EPS" came in at a positive $3.32/share. It is certainly easy to see how the lay investor might be confused when Allergan describes its "earnings" or "EPS".

THE VALEANT PRECEDENT

If investors don't want to "take my word" that Allergan's non-GAAP metrics do not comply with the SEC's regulations, perhaps they will be more convinced by the SEC's own words. Fortunately, there is a recent precedent that is highly relevant for Allergan--namely, the SEC's October correspondence with Valeant Pharmaceuticals (NYSE:VRX) regarding that company's similar use of non-GAAP EPS metrics. In reviewing Valeant's 2015 10-K and certain other filings, the SEC asked Valeant the following question (see page 9):

> Given the nature and magnitude of the vast majority of your non-GAAP adjustments, it appears that your non-GAAP adjusted net income is actually a non-GAAP liquidity measure. As such, please tell us why this non-GAAP measure is not a liquidity measure or represent to us that you will no longer present this measure on a per share basis. Please see Compliance & Disclosure Interpretation on Non-GAAP Financial Measures, or CDI, Question 102.05.

Valeant attempted to justify its non-GAAP EPS measure with the response below:

The Company respectfully acknowledges the Staff's comment. However, the Company believes that non-GAAP adjusted net income is an operating and performance measure and not a liquidity measure.

Non-GAAP adjusted net income has been one of the key metrics in the evaluation of the Company's performance. In particular, management has used non-GAAP adjusted net income for strategic decision making, forecasting future results, and evaluating current performance and gave guidance on the basis of non-GAAP adjusted earnings per share. In addition, cash bonuses for the Company's executive officers were based, in part, on the achievement of certain financial targets that were based, partially, on attaining budget or stretch targets for non-GAAP adjusted earnings per share.

Liquidity measures quantify an enterprise's ability to meet its financial obligations as they come due, both on a short and long term basis. The Company uses GAAP cash flows from operations as its liquidity measure. The Company's primary sources of liquidity are its cash on hand, cash flows generated from its operations, funds available from its revolving credit facility, issuances of long-term debt and issuances of equity or equity-linked securities, and, in certain circumstances, cash from divestitures.

Non-GAAP adjusted net income excludes the impact of certain items that management believes may obscure important trends in the Company's underlying performance. By disclosing this non-GAAP measure, management intended to provide investors with a meaningful, supplemental comparison of the Company's operating results and trends for the periods presented. Management believes this measure is also useful to investors because it allows investors to evaluate the Company's performance using the same tools that management uses to evaluate past performance and prospects for the Company's future performance. Accordingly, the Company believes that non-GAAP adjusted net income is useful to investors in their assessment of the Company's operating performance and the valuation of the Company.

The distinction between non-GAAP adjusted net income as a performance measure and GAAP cash flows from operations as a liquidity measure is reflected in the differences in the nature and the type of adjustments that are made in calculating these measures. In calculating the GAAP cash flows from operations, the Company adjusted GAAP net income by all non-cash items in GAAP net income, as well as the effects of all deferrals of past operating cash receipts and payments and all accruals of expected future operating cash receipts and payments. In contrast, the Company's calculation of non-GAAP adjusted net income adjusts for items, both cash and non-cash, that varied meaningfully in nature and amount from period to period and may obscure important trends in the Company's underlying performance. Importantly, adjusted net income {A} did not exclude all non-cash items included in GAAP net income (for example, it did not exclude depreciation expense exclusive of fair value step-up/down from purchase accounting, allowances for losses on accounts receivable and inventories, stock-based compensation exclusive of the effect of acceleration of

> vesting of certain equity awards, income tax provision exclusive of income tax effect relating to non-GAAP adjustments) and did not adjust for the effects of deferral of cash receipts and payments and {B} at the same time, excluded certain items with a cash impact (for example, acquired in-process research and development, restructuring, integration, acquisition-related and other costs, and legal settlement costs). In addition, based on the Company's calculation of non-GAAP adjusted net income, more adjustments are required to reconcile non-GAAP adjusted net income to cash flows from operations than are required to reconcile non-GAAP adjusted net income to net income calculated in accordance with GAAP.
>
> Accordingly, the Company believes that non-GAAP adjusted net income is a performance measure and not a liquidity measure.

The SEC, however, was having none of it, responding with the following rebuke:

> After reviewing your response to this comment, we may have additional comments. You indicate in response to prior comment 4 that you use non-GAAP adjusted net income as an operating and performance measure and not as a liquidity measure. Question 102.05 of the updated Non-GAAP Compliance and Disclosure Interpretations made clear, however, that whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, not on how management chooses to characterize it. Your non-GAAP measure bears a striking resemblance to your cash flows and differs drastically, including directionally, from your GAAP net income. For example, your non-GAAP net income was $487.5 million for the three months ended June 30, 2016 and your "GAAP cash flow from operations" were $448.1 million. In order to convert your GAAP net loss of $302.3 million to non-GAAP net income, you eliminated almost $800 million of mostly non-cash charges. The relationship of your non-GAAP net income to cash flows was further strengthened by the fact that, until making a change in response to staff comment issued last year, you referred to your nonGAAP measure as "cash earnings." We believe that your per share presentation is inconsistent with both Commission and staff guidance and should be discontinued

(See source here)

Per the correspondence, one key test to determine whether a non-GAAP EPS metric is a forbidden per-share liquidity measure is "[whether the] non-GAAP [per share] measure bears a striking resemblance to [the company's] cash flows and differs drastically, including directionally, from [the company's] GAAP net income". With respect to Allergan's "non-GAAP EPS" metric, we showed above that the answer to these questions is in the affirmative.

Note also the SEC's final sentence, which leaves no room for confusion: "We believe that your per share presentation is inconsistent with both Commission and staff guidance and should be discontinued."

CONCLUSION

In its SEC filings in recent years, Allergan has utilized a non-GAAP EPS metric that actually is a measure of liquidity presented on a per-share basis. However, just last May the SEC clearly stated that "non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis in documents filed or furnished with the Commission". Moreover, Allergan's non-GAAP EPS calculations appear to routinely add back amounts such as amortization and acquisition and licensing charges, despite these being recurring expenses. Allergan's non-GAAP EPS figures are thus confusing, misleading and in apparent violation of the SEC's non-GAAP published rules and guidance. We believe that Allergan will need to either completely eliminate the use of non-GAAP EPS or, at a bare minimum, substantially revise how it calculates non-GAAP EPS in order to comply with the SEC's published guidance.