

Fact Sheet -- Measures of Corporate Earnings for Equity Analysis

What is Standard & Poor's Core Earnings?

Core Earnings measure the earnings power of a company's business. It represents the difference between the revenue of a company's principal, or core, business and the costs and expenses associated with deriving that revenue. A simple example would be a chain of retail stores. The core business is running stores. Look at the revenues and the expenses from those stores and you can find core earnings. While many retail chains may buy and sell real estate, that is not their main business. Neither is running a pension fund, or many other things that such a company may do. Standard & Poor's believes that for an equity investor to make an investment decision based upon the reasonable earnings expectation of a company, it is necessary to understand how that organization's core business will perform in the future.

Each company and each industry is different, so how can you have a "one size fits all" earnings definition?

You can't. But there can be one common goal for all accounting -- a standard calculation of the earnings of a company's core business. That is Standard & Poor's goal. Our white paper, *Measures of Corporate Earnings*, addresses issues that are found across most companies in most industries. Certainly there are unusual items that occur every once in a while. A company that uses Core Earnings and is committed to using it to help investors understand the true nature of its business instead of visualizing rosy scenarios should be able to explain the unusual items and treat them properly. The White Paper notes that *pro forma* reports do have a proper place when specific assumptions must be made, providing all those assumptions are fully described and explained.

Why use Core Earnings to recalculate a company's operating earnings? Aren't current accounting practices sufficient?

In the last few years the reliability of earnings reports has dramatically decreased. As Standard & Poor's business is based on providing investors with reliable information, analysis and advice, it believes it is time for the investment community at large to take corrective action. Accordingly, Standard & Poor's feels that earnings reports must be understandable, consistent and transparent.

Will Standard & Poor's ever change its definition for Core Earnings?

The basic idea of Core Earnings won't change. To make its calculations, Standard & Poor's will focus on a company's main business. However, as business reporting improves and accounting rules change, there may be refinements.

How will Standard & Poor's use Core Earnings?

First, our equity analysts will consider Core Earnings when they analyze and review stocks. While neither core earnings nor any other single measure will determine an analyst's opinion on a stock, we believe earnings measures that are consistent across companies and over time are important. Second, to assist our own equity analysts and analysts and investors in general, we will begin calculating Core Earnings per share for our U.S. indices and the main sectors in those indices. Third, supporting data will be in Standard & Poor's COMPUSTAT database later this year.

Has Standard & Poor's talked to others about Core Earnings?

Yes. From the outset, Standard & Poor's investment analysis group consulted regularly with numerous securities and accounting analysts, portfolio managers, academic research groups and others. While there is some disagreement on the details, everyone agrees that this is an important, positive effort – important for investors and the broader financial investment community.

Why is the expense treatment of stock options so important?

In 2000, the cost of stock options was nearly 10% of profits, demonstrating that such expenses can be substantial. For 2001 the value will be even higher. If stock option expenses are ignored, profits may be misrepresented. Moreover, stock options can directly affect shareholders because when options are exercised new shares are issued and shareholders' existing holdings are diluted.

Does Core Earnings take restructuring into account?

Yes. In arriving at its Core Earnings calculation, Standard & Poor's includes the restructuring charges that stem from the company's ongoing operations as an expense. From time to time a company may make some changes to its core business. It may drop a product line or close a factory. Restructurings often result in additional expenses including severance payments to employees who lose their jobs and write-downs of assets that are no longer needed. In some restructurings a company may completely and permanently abandon an entire line of business and the change is a discontinued operation. In these cases the charges are not included since the company is no longer in that business. However, in most cases the restructuring is an adjustment to an existing and ongoing part of the core

business. When this happens, the costs involved in the restructuring are costs of the business and should be included in calculating Core Earnings.

What about goodwill impairment charges?

Until this year companies were required to amortize goodwill – showing a cost representing a scheduled portion of goodwill each period. Under the new GAAP rules companies do not show a charge each period for goodwill. However, if the goodwill becomes impaired – if it turns out to be worth less than its book value – an impairment charge must be taken. Given the new rules, Standard & Poor's does not include goodwill impairment charges in Core Earnings.

If Core Earnings had been available a year or two ago, would investors have fared better in the bear market?

If corporate reporting had been more consistent and transparent than it has been, many corporate reports boasting profits would have shown losses. As a result, investors would have had more detailed information on which to base their decisions.

Will Standard & Poor's use Core Earnings as part of its debt rating activities?

Yes. The accuracy of earnings and earnings trends has always been a component of credit analysis and Core Earnings thus adds value to that process. Earnings are a major component in cash flow analysis and are a part of Standard & Poor's debt rating methodology.