

CLAY TOKENS

The Uniform Accounting Monthly Report | September 30, 2022



Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Banks are far from your typical business

Mitsubishi Group is a classic Japanese conglomerate.

Also known as “Keiretsu” in Japanese, it is a series of cross-shareholdings that form a complicated corporate structure under a single business group.

Mitsubishi has a host of businesses under its umbrella. Arguably best known for its motor vehicles, at least in the United States, Mitsubishi also manufactures toasters... and Nikon cameras. It also runs an aircraft business, sells specialty chemicals and industrial gasses, develops real estate, manufactures generators, and does much, much more.

While assessing the performance of the group’s combined activities would be a sufficiently difficult activity, there is one area of the group that makes it nearly impossible.

Mitsubishi also operates a bank.

Its banking arm, logically, is very different from the other operating parts of its business.

While those may be different in terms of what they sell and how they are run, at least they are fairly consistent in how they record their finances. For banks, on the other hand, the balance sheet is completely flipped.

While most companies make their money off their assets, banks make their money off their liabilities or the deposits that they subsequently loan out.

To a bank, this loan becomes an asset. Banks make money from the spread of their lending business. This is the difference between the interest received from loans and the interest paid to depositors.

In general, the ability of a business to invest its capital into operating assets and in turn see incremental operating returns allows it to create long-term value.

**Presented to the UAFRS
Advisory Council**

Prepared by Valens Research
1(917) 284 6008

Joel Litman, CPA
Chief Investment Strategist

Rob Spivey, CFA
Director of Research

Angelica Lim
Research Director

Kyle Pinkerton, CFA
Senior Analyst

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

That's part of the reason why Uniform Return on Assets (Uniform ROA) is the backbone of how we value most companies. Evaluating the return on a company's operating assets, or in essence, its invested capital, gives a picture of the company's operating profitability, or true earning power.

However, evaluating a bank on the basis of Uniform ROA would not make as much sense. As stated above, the assets of a bank are not akin to the assets of an operating company.

Instead, we must use Uniform Return on Equity (Uniform ROE) to value banks. The equity is the invested capital the bank actually needs to be able to run its business, since it is what allows it to accumulate the deposits of others that it then loans out.

Therefore, Uniform ROE is how banks see incremental returns. Evaluating based on this metric gives a more accurate understanding of a bank's underlying operating performance.

The Mitsubishi Group is a tremendous example of the complexity of modern companies and how one single firm could be involved in so many different and unrelated activities. It also shows how banks and bank-like operations are not always separate from regular operating businesses.

So, how then, would you value a company that has both operating entities and a banking entity?

Unlike Mitsubishi, whose complicated cross-holding structure avoids a true parent-subsidary relationship, there are a host of other companies, notably American automotive companies as an example, that have banking entities embedded in the overall corporate structure.

Also known as a financial subsidiary, these entities are allowed to engage in certain financial activities that the parent company itself is not allowed to, including lending, participation in underwriting, securities, and insurance activities.

While companies may have different forms of financial subsidiaries, it is critical to always consider "operating" financial subsidiaries in any corporate performance analysis. These are the financial subsidiaries that are vital in sustaining the day-to-day operations of the regular business (e.g. the auto company). Without them, the "regular" business would not be able to operate as efficiently.

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

This subsidiary must be considered in the evaluation of the entire company. However, since a financial subsidiary operates more like a bank, it should not be added to the balance sheet in the same way a run-of-the-mill subsidiary would.

Simply adding the assets of the financial subsidiary into the parent company's balance sheet would distort ROA calculations, leading to a material over or understatement of true earning power. Counting the operating financial subsidiary's assets as traditional assets is misleading because those assets more closely resemble the parent company's liabilities.

Instead, we must focus on evaluating the combined firm's return on invested capital. For the parent company, this invested capital is effectively its asset base, and why ROA is appropriate. For the financial subsidiary, it is effectively its equity value, and why ROE suffices.

As such, the adjustment is fairly straightforward. To incorporate the financial subsidiary, simply add its equity value, the difference between its assets and liabilities, to the parent company's balance sheet as a long-term operating asset.

Given that the operating financial subsidiary is necessary for the business to function, it should be assumed to be a part of the long-term recurring functions of the overall entity.

Meanwhile, the combination of a bank-like invested capital base and an operating company invested capital base, gives a more level playing field from which to evaluate the combined corporate capital base.

This adjustment allows for a better understanding of the combined entity's profitability. It also allows investors to compare companies with financial subsidiaries to those without them interchangeably. That would be impossible if you were trying to compare a bank to an operating company.

CLAY TOKENS

The Uniform Accounting Monthly Report | September 30, 2022

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

There is a long line of firms, from various sectors, where as-reported assets do not represent economic reality due to the misrepresentation of financial subsidiary assets.

This month, we highlight three companies wherein the full inclusion of financial subsidiary assets as operating assets limit the reliability of the firm's reported asset-based ratios:

- Snap-on Incorporated, a tools and equipment manufacturer for the transportation industry;
- The Boeing Company, a leading aircraft manufacturer and defense company;
- General Motors, a legacy American auto manufacturing giant.

In the pages and charts below, we show the difference between the adjusted financial subsidiary equity and reported financial subsidiary assets for these firms and the difference between as-reported GAAP Assets and UAFRS-based Assets.

While all of the 130+ adjustments have been applied, we home in on how this line item in particular can create material deviations from economic reality.

In each case shown below, it's quite obvious the stock market does not and has not valued firms on GAAP earnings.

These examples highlight just how bad the as-reported numbers are, from a database of more than 32,000 companies wherein Uniform Accounting and GAAP/IFRS accounting differences are shown.

The report name "Clay Tokens" comes from the earliest known form of accounting and bookkeeping and a foundation for tracking the earliest debits and credits. In this regard, Uniform Accounting is an attempt to get financial statements back to the foundations of the purpose of accounting... to be useful to the users of the accounting information. Clay Tokens is produced monthly by Valens Research on behalf of and for the UAFRS Advisory Council for Uniform Adjusted Financial Reporting Standards.

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

[SNA](#) – Snap-on Incorporated

Since 2019, [SNA](#) has seen increasingly robust profitability, driven by strength in homebuilding markets (Exhibit 1a).

Reflecting this UAFRS-based earnings trend, the firm has seen a material appreciation in stock price, generally moving in the same direction as its Uniform-calculated earnings.

Meanwhile, GAAP earnings have remained largely flat over this same time period. This steady performance fails to explain the firm's improving stock price, displaying how current accounting standards enable a dislocation between economic reality and as-reported performance.

[SNA](#) share prices appreciated materially in value, rising from \$150 at the start of 2019 to over \$220 by the end of 2021, a 43% gain (Exhibit 1b). That said, according to as-reported metrics, [SNA](#) appeared to be a firm that had remained stagnant, with stable, corporate-average levels of profitability over the same time period. This steady performance implies the firm's stock price positive movements are wholly unwarranted.

However, using Uniform Accounting, we can more accurately account for the performance of financial subsidiaries, which need to be evaluated more like banks than traditional operating businesses. Under as-reported metrics, financial subsidiary assets are counted as regular assets, despite acting similarly to liabilities, which can result in overstated total assets, and in turn, artificially deflate profitability measures (Exhibit 1c).

UAFRS-adjusted metrics paint a significantly different picture of [SNA](#), as Uniform ROA climbed from an already robust 19% in 2019 to even stronger 23% levels by 2021, suggesting that the increase in the firm's stock price has likely been justified.

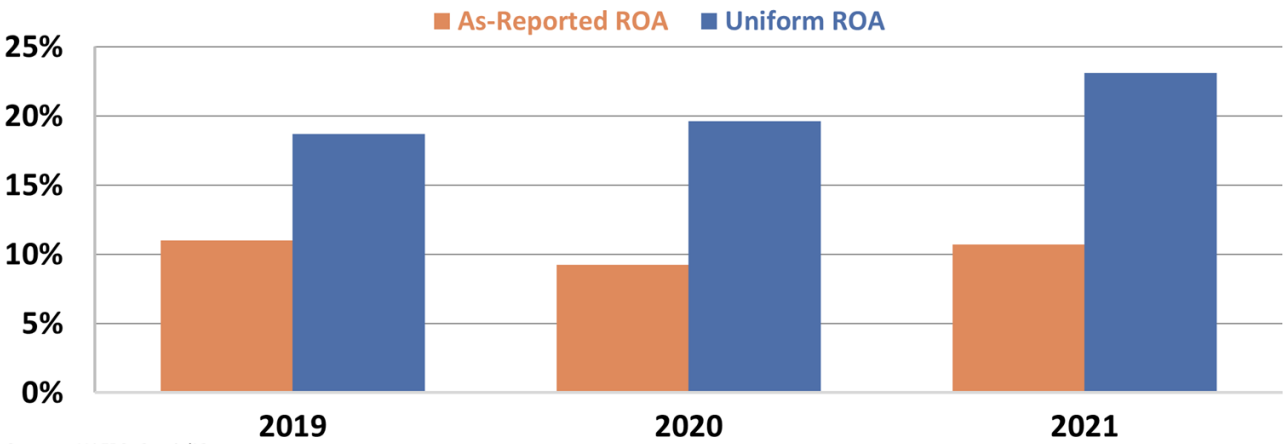
CLAY TOKENS

The Uniform Accounting Monthly Report | September 30, 2022

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Exhibit 1a

Snap-on Incorporated (SNA) Uniform ROA vs. ROA



Sources: UAFRS, CapitalIQ

Exhibit 1b

Snap-on Incorporated (SNA) Stock Chart



Source: CapitalIQ

Exhibit 1c

SNA - Snap-on Incorporated	2020	2021	2022
Uniform Operating Financial Subsidiary Equity	1146.9	726.8	968.3
As-reported Financial Subsidiary Assets	2096.8	2162.2	2156.1
Uniform Net Assets	3757.9	3324.6	3725.9
Total Assets	5693.5	6557.3	6759.7
% Variance	51.5%	97.2%	81.4%
Uniform ROA	18.7%	19.6%	23.1%
As-Reported ROA	11.0%	9.2%	10.7%
Uniform ROA vs ROA - Variance	7.7%	10.4%	12.4%

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

[BA](#) – The Boeing Company

Prior to a steep drop off in performance caused by controversies around aircraft safety, and then the impact of the pandemic, [BA](#) saw material improvements in profitability from 2016 to 2018 (Exhibit 2a).

Reflecting this UAFRS-based earnings trend, the firm saw its stock performance rise rapidly, moving in the same direction as its Uniform-calculated earnings.

Yet, GAAP earnings show a firm with profitability that only marginally improved, remaining near cost-of-capital levels. This lackluster performance is misaligned with the firm's impressive stock performance, displaying how current accounting standards enable a dislocation between economic reality and as-reported performance.

[BA](#) shares rose from \$130/share at the beginning of 2016 to over \$310/share by the end of 2018, a 135%+ increase (Exhibit 2b). That said, according to as-reported metrics, [BA](#) appears to be a firm which saw only slight improvement in profitability, with as-reported ROA rising from a paltry 4% in 2016 to just 5% in 2018. This does not appear to be the financial performance of a firm deserving significant appreciation in its share price.

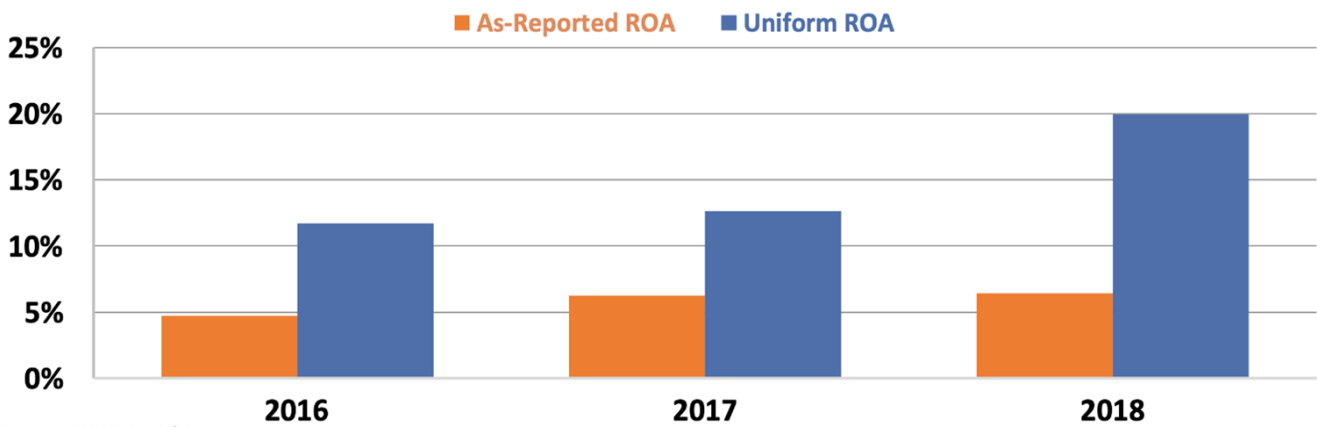
However, using Uniform Accounting, we can more accurately account for the performance of financial subsidiaries, which need to be evaluated more like banks than traditional operating businesses. Under as-reported metrics, financial subsidiary assets are counted as regular assets, despite acting similarly to liabilities, which can result in overstated total assets, and in turn, artificially deflate profitability measures (Exhibit 2c).

UAFRS-adjusted metrics paint a significantly different picture of [BA](#) where Uniform ROA jumped from 12% to over 20% during the same three-year period. This earning trend more clearly justifies the firm's stock price performance.

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Exhibit 2a

The Boeing Company (BA) Uniform ROA vs. ROA



Sources: UAFRS, CapitalIQ

Exhibit 2b

The Boeing Company (BA) Stock Chart



Source: CapitalIQ

Exhibit 2c

BA - The Boeing Company	2016	2017	2018
Uniform Operating Financial Subsidiary Equity	661.0	542.0	378.0
As-reported Financial Subsidiary Assets	4201.0	3065.0	2878.0
Uniform Net Assets	57396.3	54803.0	52255.3
Total Assets	89997.0	112362.0	117359.0
% Variance	56.8%	105.0%	124.6%
Uniform ROA	11.7%	12.6%	20.0%
As-Reported ROA	4.7%	6.2%	6.4%
Uniform ROA vs ROA - Variance	7.0%	6.4%	13.5%

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

[GM](#) – General Motors Company

Between 2017 and 2021, [GM](#) saw profitability improve materially, finally eclipsing cost of capital levels (Exhibit 3a).

To accompany this trend in Uniform-calculated earnings, the firm's stock price dramatically rose, with the exception of a dip in 2020 due to pandemic-related headwinds.

Meanwhile, GAAP earnings have remained fairly stagnant over this same time period, portraying the firm as one that has failed to see any improvement in its operating fundamentals. Faulty accounting treatment distorts the economic reality of the firm's performance.

Since 2017, [GM](#) shares have seen material appreciation, rising from \$38/share at the beginning of 2017 to \$60/share at the end of 2021 (Exhibit 3b), an almost 60% increase. That said, according to as-reported metrics, [GM](#) appears to be a firm with stagnant profitability, as ROA remained at weak sub-3% levels. This does not appear to be a firm with performance that would justify its rising stock price.

However, using Uniform Accounting, we can more accurately account for the performance of financial subsidiaries, which need to be evaluated more like banks than traditional operating businesses. Under as-reported metrics, financial subsidiary assets are counted as regular assets, despite acting similarly to liabilities, which can result in overstated total assets, and in turn, artificially deflate profitability measures (Exhibit 3c).

UAFRS-adjusted metrics paint a different picture of [GM](#), where Uniform ROA rose from 5% in 2017 to 7% in 2021, eclipsing its cost of capital. These improving profitability metrics better explain the rationale behind the firm's stock price appreciation over this time period.

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Exhibit 3a

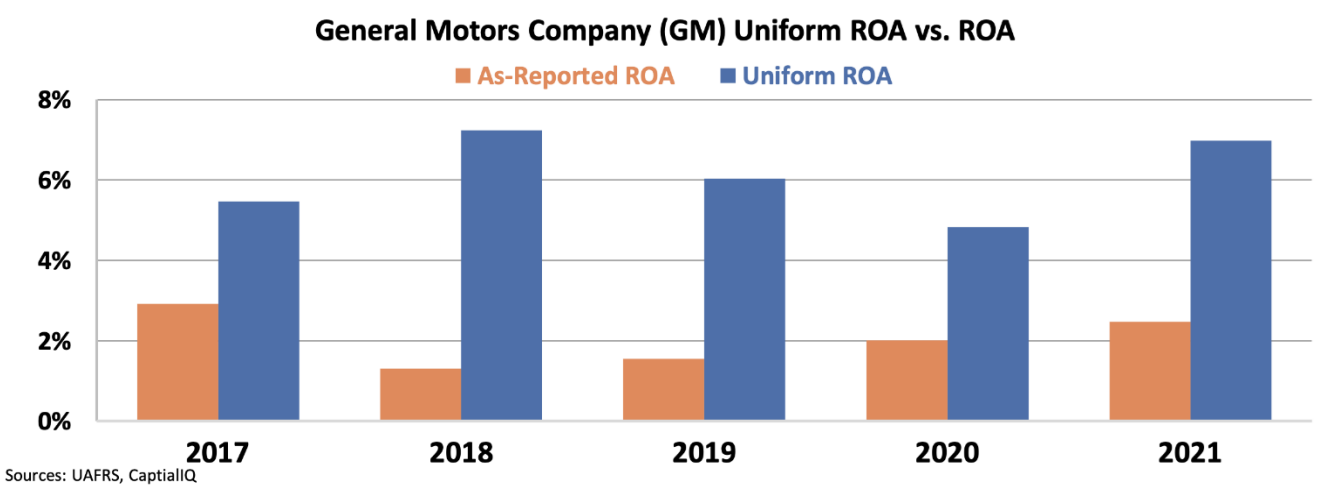


Exhibit 3b

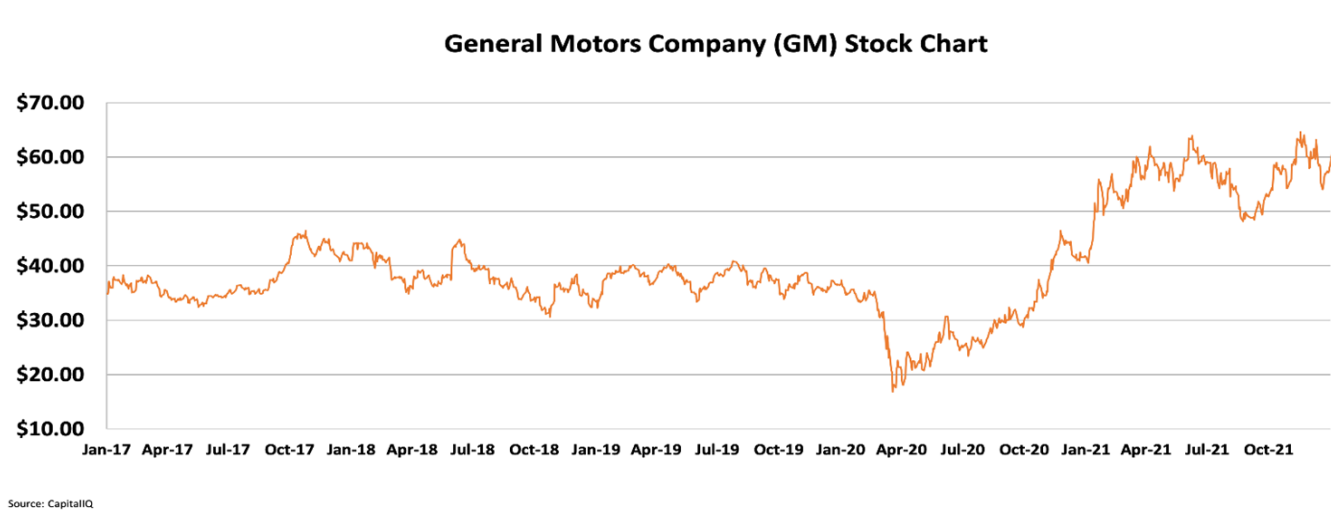


Exhibit 3c

GM - General Motors Company	2017	2018	2019	2020	2021
Uniform Operating Financial Subsidiary Equity	13404.0	14938.0	15166.0	17003.0	18826.0
As-reported Financial Subsidiary Assets	94061.0	105855.0	104104.0	109428.0	111387.0
Uniform Net Assets	74569.5	77267.8	86350.1	89010.0	99291.6
Total Assets	212482.0	227339.0	228037.0	235194.0	244718.0
% Variance	184.9%	194.2%	164.1%	164.2%	146.5%
Uniform ROA	5.5%	7.2%	6.0%	4.8%	7.0%
As-Reported ROA	2.9%	1.8%	1.8%	2.3%	3.0%
Uniform ROA vs ROA - Variance	2.5%	5.5%	4.3%	2.5%	4.0%

CLAY TOKENS

The Uniform Accounting Monthly Report | September 30, 2022

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Definitions

Uniform Net Assets – Net Asset' is calculated as Net Working Capital + Long Term Non-Depreciating Operating Assets (including Land and Non-Depreciating Operating Intangible Assets, excluding Goodwill and other acquisition-related Intangible Assets) + Inflation-Adjusted Net PP&E + Net Capitalized R&D + Net Capitalized Leases + Net Depreciating Operating Intangible Assets

Uniform ROA – UAFRS-adjusted ROA is a cleaned-up Return on Asset ratio, used to understand the operating fundamentals of the company. UAFRS-adjusted ROA is Earnings' divided by Asset'.

Uniform Earnings is calculated as Net Income + Special Items + Interest Expense + Depreciation and Amortization Expense + R&D Expense + Rental Expense + Minority Interest Expense + Pension Charges + LIFO to FIFO adjustments + Stock Option Expense + Purchase Accounting Cash Flow Adjustments - Non-Operating (Investment) Income - Asset Life Based Charge on Depreciating Assets. Asset' is Net Asset', or Net Working Capital + Long-Term Non-Depreciating Operating Assets (including Land and Non-Depreciating Operating Intangible Assets, excluding Goodwill and other acquisition related Intangible Assets) + Inflation Net PP&E + Net Capitalized R&D + Net Capitalized Leases + Net Depreciating Operating Intangible Assets.

CLAY TOKENS

The Uniform Accounting Monthly Report | September 30, 2022

Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Disclaimer

© 2022 (Valens Research LLC, Valens Credit LLC, Valens Securities, Equity Analysis & Strategy and Altimetry Research and/or its licensors, predecessors, successors, parents, subsidiaries, affiliates, officers, directors, shareholders, investors, employees, agents, representatives, and attorneys and their respective heirs, successors, and assigns hereinafter referred to as the "Valens").

All rights exclusively and explicitly reserved.

Credit, business, equity, asset and asset allocation, income and outcome, growth, liquid, investment, spending, income, cash and cash flow or any kind of analyses issued hereby, in this presentation, by Valens ("Valens' Analyses"), are Valens' current opinions of the relative future credit or personal asset and asset allocation risks, business, equity and other related assets of the relevant persons, entities, credit commitments, or debt or debt-like securities, credit, business and risk analyses, and research publications published or soon to be published or shared by or with in association with Valens ("Valens Publications") may include Valens' current opinions of the relative future credit or cash or asset risk of entities or persons, credit commitments, income, outcome or debt or debt-like securities, business, equity and other related assets.

Valens' Analyses and Valens Publications do not constitute or provide professional investment or financial advice to any person or company. Valens' Analyses and Valens Publications are not and do not provide professional recommendations to purchase, sell, or hold particular securities, spend or hold personal assets and properties.

Valens accepts no liability and responsibility from any kind of damage or responsibility that may arise from any false notion, misguidance or mistake regarding this. Valens' Analyses may not address any other risk arising either from personal or commercial investment and action.

Neither Valens' Analyses nor Valens Publications comment on the suitability of an investment or allocation for any particular person and neither Valens' Analyses nor Valens Publications under any circumstance accept any kind of liability or responsibility arising from self-misguidance of any particular person or any other 3rd parties.

Valens issues Valens' Analyses and publishes Valens Publications with the expectation and understanding that each 3rd party and each user of the information contained herein or to be issued by Valens will make their own study and evaluation, in a deliberate, cautious and prudent way, of each security that is under consideration for purchasing, holding, selling or for any transaction.

It would be dangerous for 3rd parties or any other information receivers, to make any financial or investment decision based solely on any of the Valens' ratings or Valens' Analyses. If in doubt, you should contact your financial or other professional adviser.

All information and calculation contained herein is obtained by Valens from sources believed by it to be accurate, up to date and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "as is"; without representation of accuracy or any kind of warranty, obligation or any kind of commitment and undertaking.

Valens adopts all reasonable measures so that the information used or to be used assigning a credit, business, equity or any other rating if any, is of sufficient quality. Valens considers from its sources including, when appropriate, independent third-party sources, to be reliable.

However, Valens is not an auditor and cannot in every instance independently verify or validate information received in the rating or any other process. Under no circumstances shall Valens have any liability or responsibility to any person or entity/entities for any kind of loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of Valens in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation loss of profits), even if Valens is advised in advance of the possibility of such damages, resulting from the use of or inability to use of any such information.

Any analysis, financial reporting analysis, projections, calculations, assumptions and other observations constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities and/or assets. Each user of the information contained herein must make their own study and evaluation, in a deliberate, cautious and prudent way, of each security considered for purchasing, holding, selling or doing any kind of transactional action whether for trade or personal purposes.

No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information or calculation is given or made by Valens in any form or manner whatsoever.

All intellectual property rights in relation to Valens' Analyses and Valens Publications and any information or material contained herein are the exclusive property of Valens. Aforementioned cannot be copied, recorded by any audio or video recording device, screen capturing or screen recording device or any device capable of performing such function and cannot be reproduced or used without the mutual and prior written consent of respective right owner(s). 3rd parties cannot use Valens' Analyses or Valens Publications for advertising purposes, to solicit business or for any other purpose. Using, copying or reproducing any materials, content and information of Valens' Analyses is prohibited, unless permitted by speakers in writing. It is strictly prohibited to reproduce, record, represent, display, modify, adapt or translate Valens' Analyses or Valens Publications and/or any work and material contained herein in whole or in part, whether for free or for financial consideration, without speakers' mutual and prior written consent.

Valens' Analyses, including the attached exhibits or documents, if any, is confidential and is intended for the sole and exclusive use of the person to whom this material has been delivered by Valens. Any further distribution, divulgence or reproduction of these materials is strictly prohibited.

All information contained herein is protected by relevant law of United States of America, including but not limited to copyright law and intellectual property law and none of such information may be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, including but not limited to commercial or non-commercial use, in whole or in part, in any form or manner or by any means whatsoever, by any person or legal entity/entities without Valens' prior and explicit written consent and civil and criminal liability will arise in violation of the mentioned above.