



Investment
Perspectives

Share based payments are an expense!

March 2025

As capital becomes more global, the trend to compare the pricing of global companies to local is on the rise. This is especially so in real estate where there are many global REITs that operate in similar sectors to Australian REITs (retail, data centres, industrial etc).

However, this can be somewhat problematic. For instance, most US companies do not revalue assets, so 'Net asset backing' ratios are not available. Instead, sell side research analysts estimate the market value of a company's real estate, which is subjective and often provides a range of estimates.

What about earnings? Well, that is when comparisons become really tricky.

Global real estate earnings are not comparable

On January 1, 2005, Australia adopted the international financial reporting standards (IFRS) replacing Australian generally accepted accounting principles (GAAP). This required REITs to mark-to-market all assets through the profit and loss including asset revaluations, interest rate and currency derivatives and other tradable instruments. These standards were also introduced in Europe (2002) and the UK (2005).

In the US, generally accepted accounting principles (US-GAAP) remain in force.

Looking back, the introduction of IFRS in Australia created more complications for REITs than it solved. Most investors and analysts recognise the mark-to-market impacts of tradable assets and liabilities were not permanent and often disguised the underlying cashflows of a REIT.

Step in, 'operational earnings'.

Management teams over the years have re-presented statutory earnings in the form of operational earnings. The problem with this, is many companies have a different definition on what exactly operational earnings should include or exclude.

Fund from operations (FFO)

The aim of deriving operational earnings is to arrive at a sustainable earnings number, which for REITs is generally viewed as Fund from Operations (FFO). However, since companies have different definitions of operational earnings, the make-up of REITs FFOs can vary.

The problem is exacerbated with 'earnings guidance'. Since analysts provide third party profit forecasts that align (and often match) company guidance, it means analysts too have an inconsistent approach to FFO and profits. This makes earnings multiples that much more difficult to compare.

There are quite a few areas where companies vary on the treatment of revenues and earnings. However, one area that continues to attract our attention is 'stock-based compensation', or SBC. That is, employee expenses paid via the issue of new company stock, rather than cash.

Stock based compensation (SBC) is an expense and should be treated as such

Global REITs can vary the treatment of SBC for their earnings, and these differences can be material.

Let's make one thing clear: **stock-based compensation is an operating expense**. And the fact we find this point even debatable in some circles is astounding.

Last year we attended several company meetings – some with our investees, and many with potential future prospects. On more than one occasion we were told that SBC should not be considered a P&L expense since "it is already being recognised as ongoing dilution in share count – and you shouldn't have to count an expense twice".

This argument, of course, is complete non-sense.

Consider a wages bill paid in cash via drawing down on a revolver. Can a company exclude this expense from the P&L since they will be “paying more interest on the otherwise higher loan balance”? Of course not. No one does this because it does not make sense. A company would be laughed out of the room with such an assertion.

What about a company that pays all expenses via shares and immediately buys them back. The vendors have cash as per normal and the company has zero expenses. The company converts earnings per share to sales per share and looks cheap relative to the peers. Again, this makes no sense.

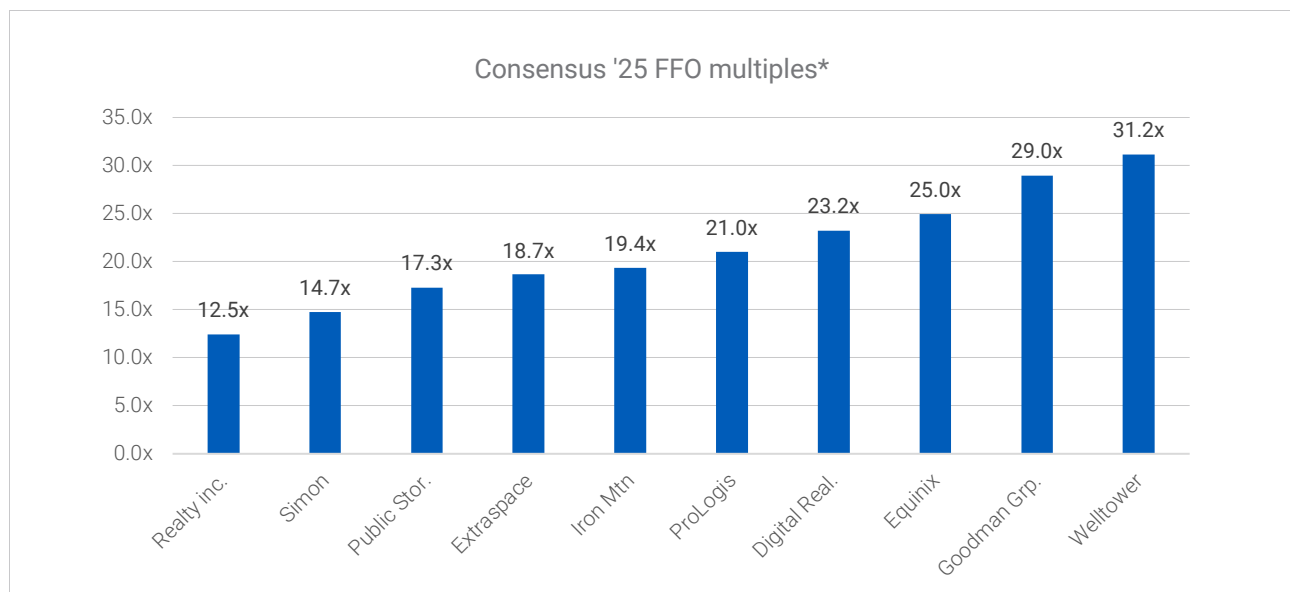
Any company using the same argument for SBC is equally illogical.

All expenses are recognised twice as they need to be funded – whether they are wages, rents, marketing costs or anything else. This funding can be via higher ongoing interest expense (lower ongoing return on cash) or dilution in the share count. Either way, they need to be expenses through the profit and loss statement. By excluding share-based compensation from operational earnings, companies are overstating, (and in our view at times manipulating) their profitability.

Global case study

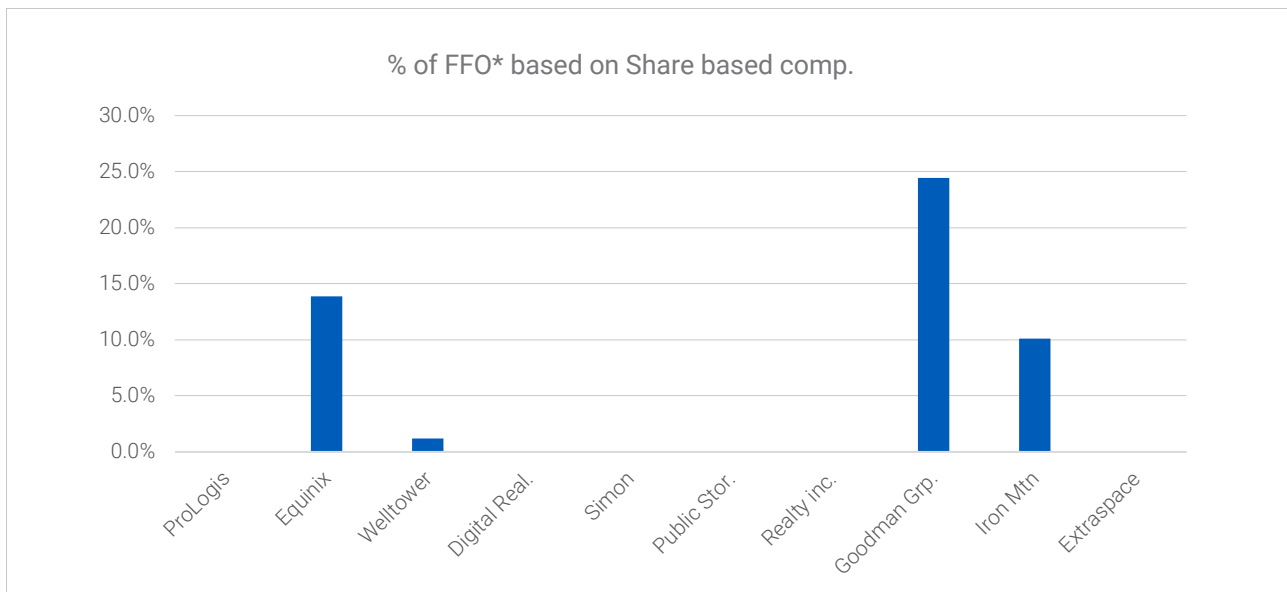
This issue (among others) can cloud a global FFO/EPS multiple for comparative purposes.

Imagine you wish to look at the earnings multiples of the top ten global REITs. Based on consensus earnings these multiples roughly look like this.



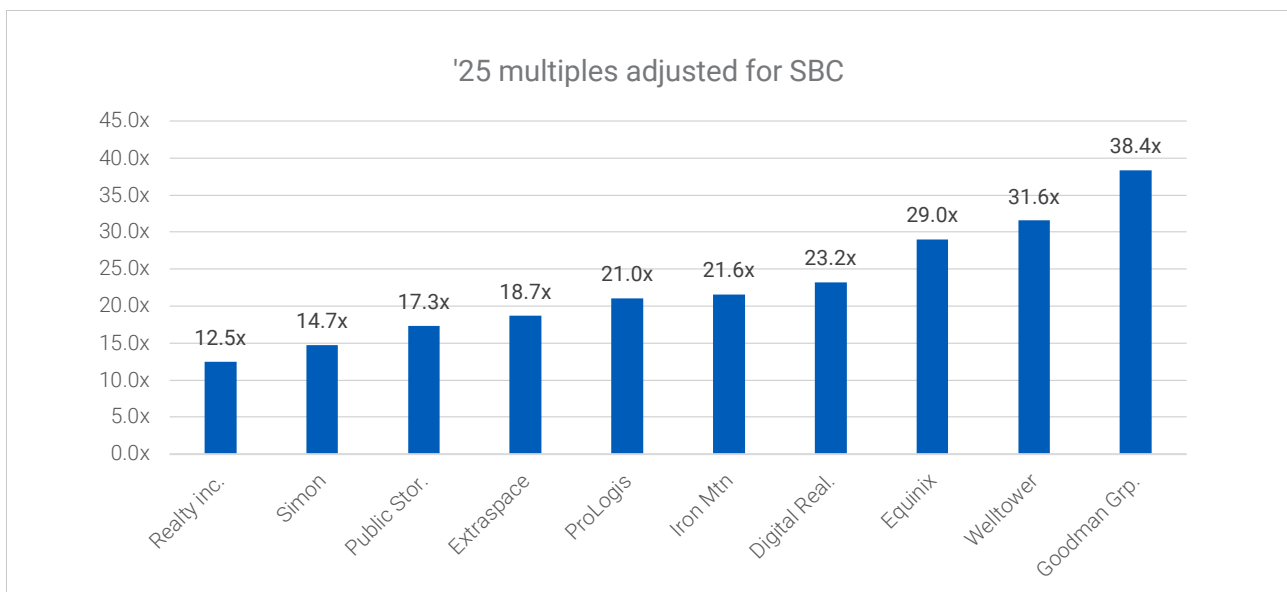
Source: FactSet. Note: Consensus earnings to June / Dec 2025. Prices as of Feb 18, 2025. * Equinix is an AFFO multiple

However not all earnings are the same. The chart below highlights the percentage of ‘operational earnings’ or FFO for each company that includes adding-back stock-based compensation expenses. (we used 2024 actual results as the basis for the comparison).



Source: Company filings, Quay Global Investors. Note: Date for full year to June 30 year end, and for the 12 months to Sept for Dec year end.
 * Equinix guide to 'AFFO' which includes allowance / deduction for maintenance CAPEX. Some companies add-back SBC to their AFFO.

If we adjust the price multiples for a true like for like comparison (that is, treating employee expense as an expense irrespective on how it is funded), we get a different outcome.



Source: FactSet, Quay Global Investors. Note Equinix guides to 'AFFO', which deducts maintenance CAPEX so is not directly comparable.

Concluding thoughts

Different international accounting regimes have left an opening for many companies to re-define operational earnings. To us some of these appears reasonable (adjusting for revaluations, currency swaps etc). Some are debatable. Yet we believe ignoring stock-based compensation as an expense is indefensible. The idea that the newly issued employee shares are already included in the EPS / FFO calculation and would therefore be double counted as an expense does not stand up to logic.

Meaningful global comparisons require consistent treatment across financial accounts. Various accounting regimes makes this difficult. Company defined operational earnings, mirrored by sell side consensus, make the comparison meaningless (if based off consensus).

The next time you see a global REIT at a 'reasonable value' based on global comparisons, it may be wise to treat it with some level of scepticism.

For more insights from Quay Global Investors, visit quaygi.com

Get in touch



quaygi.com



client.experience@bennelongfunds.com



1800 895 388 (AU) or 0800 442 304 (NZ)

The content contained in this article represents the opinions of the authors. The authors may hold either long or short positions in securities of various companies discussed in the article. The commentary in this article in no way constitutes a solicitation of business or investment advice. It is intended solely as an avenue for the authors to express their personal views on investing and for the entertainment of the reader.

This information is issued by Bennelong Funds Management Ltd (ABN 39 111 214 085, AFSL 296806) (BFML) in relation to the Quay Global Real Estate Fund (Unhedged) and the Quay Global Real Estate Fund (AUD Hedged). The Funds are managed by Quay Global Investors, a Bennelong boutique. This is general information only, and does not constitute financial, tax or legal advice or an offer or solicitation to subscribe for units in any fund of which BFML is the Trustee or Responsible Entity (Bennelong Fund). This information has been prepared without taking account of your objectives, financial situation or needs. Before acting on the information or deciding whether to acquire or hold a product, you should consider the appropriateness of the information based on your own objectives, financial situation or needs or consult a professional adviser. You should also consider the relevant Information Memorandum (IM) and or Product Disclosure Statement (PDS) which is available on the BFML website, bennelongfunds.com, or by phoning 1800 895 388 (AU) or 0800 442 304 (NZ). Information about the Target Market Determinations (TMDs) for the Bennelong Funds is available on the BFML website. BFML may receive management and or performance fees from the Bennelong Funds, details of which are also set out in the current IM and or PDS. BFML and the Bennelong Funds, their affiliates and associates accept no liability for any inaccurate, incomplete or omitted information of any kind or any losses caused by using this information. All investments carry risks. There can be no assurance that any Bennelong Fund will achieve its targeted rate of return and no guarantee against loss resulting from an investment in any Bennelong Fund. Past fund performance is not indicative of future performance. Information is current as at the date of this document. Quay Global Investors Pty Ltd (ABN 98 163 911 859) is a Corporate Authorised Representative of BFML.