"DISCLOSURE REQUIREMENTS UNDER FEDERAL SECURITIES REGULATION"

ADDRESS BY

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I appreciate very much the opportunity to participate in your meeting and the hospitality which you have shown to me. I hope to make some points as to the theory and purpose of disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934. Although I shall direct most of my remarks to the Securities Act, generally my statements are also applicable to the disclosure requirements for reporting by companies registered under the Securities Exchange Act of 1934. However, any points that I do make, I am sure you must realize, are entirely an expression of my own views. They do not necessarily reflect the views of other members of the staff or of the Commission itself. The Commission, as a matter of policy, disclaims responsibility for any private publication of any of its employees. The most I can present to you is the behavior pattern of one assistant director of the Division of Corporation Finance.

The Securities Act is essentially a legislative device to obtain certain basic information essential to an investment analysis. Criminal and civil sanctions are imposed for material misrepresentations or omissions
of material facts necessary to make the facts stated not misleading. To accomplish its purpose the Act prohibits the use of the mails and the facilities of interstate commerce to the sale of securities or the delivery of securities after sale unless and until a registration statement has become effective in respect of such securities. The registration statement includes a prospectus which must be given to the investor at the earliest of confirmation of his purchase, payment for, or delivery of the security. After the filing of a registration statement, sale may not be affected for a prescribed waiting period. During this period a testing of the truth and accuracy of the statements made in the registration statement is undertaken by the staff of the Commission's Division of Corporation Finance. I do not wish you to get the impression that our examination guarantees accuracy or that it will absolve the company from liability. We cannot be in possession of all of the facts known to the company. At most we can depend only on the material in the registration statement, other material concerning the company on file with the Commission, our
general knowledge of industry and our knowledge of the particular industry
to aid us in our analysis. I cannot emphasize too strongly the fact that
the accuracy and adequacy of the registration statement is ultimately the
responsibility of the company and its directors, officers, underwriters
and the independent public accountants whose audit and certificate in
respect of financial statements is required by the statute. The statute
itself makes it a crime to represent that either the filing or the
effectiveness of any registration statement is any guarantee of its
accuracy or constitutes any approval of the security by the Commission.
The statute reads:

"Neither the fact that the registration statement for a
security has been filed or is in effect nor the fact that a
stop order is not in effect with respect thereto shall be deemed
a finding by the Commission that the registration statement is
true and accurate on its face or that it does not contain an
untrue statement of fact or omit to state a material fact, or be held to mean that the Commission has in any way passed upon the merits of, or given approval to, such security. It shall be unlawful to make, or cause to be made, to any prospective purchaser any representation contrary to the foregoing provisions of this section."

The statute itself sets forth 32 items and areas of information which registering companies are required to set forth in the registration statement. The Commission is given power to add to such informational requirements or to subtract from them to the extent that it believes that the residual disclosure is "fully adequate for the protection of investors". The contents of the prospectus are also prescribed by the statute unless the required content is varied by the Commission in the "public interest and for the protection of investors". Finally the statute imposes stringent civil liabilities on the company, its directors, certain of its officers, its underwriters, its certified public accountants and others. Liabilities are imposed upon these individuals for any untrue statement of a material fact or omission of a material fact
required to be stated by the registration statement form or necessary to make the statements made therein not misleading. The Commission is authorized to suspend the effectiveness of the registration statement and in effect to stop the sale of securities to the public if it finds that the registration statement contained statements or omissions of the same character.

The statute however does not define the term "material". In its rules the Commission has defined that term when used to qualify a requirement for the furnishing of information as to any subject as limiting the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the securities registered.

It is the job of the Commission to place flesh and bones on such general concepts as "public interest" and "protection of investors" and "information as to which an average prudent investor ought reasonably to be informed". To accomplish this, in my opinion, recourse must be made to the views of economists, financial analysts, investment bankers, accountants and others concerned with the theory of investment for a determination of more precise rationales and guides as to the information required to make investment determinations. Needless to say these groups are always consulted by the
Commission as a matter of practice in its preparation of registration forms.

Fundamentally the purchase of a bond, a preferred stock or common stock is an investment in a new or a going, continuing enterprise. Liquidating enterprises or enterprises which are about to liquidate do not sell securities to the public. Essentially an investment, whatever the type of security, is a participation in a business aggregate which is expected to continue in existence for profit-making purposes. Ordinarily the investor will not have it in his power to liquidate or otherwise cause the termination of the enterprise. The economic purpose of the investment is to obtain as great a return for the use of the investor's funds as can be obtained with safety of principal; ultimately the investor is staking his funds on the future profit-making ability of the enterprise.

The intrinsic value of the investment, therefore, will depend upon the future earnings of the enterprise which will accrue to the security under the terms of the contract which the security represents. As early as 1904 Veblen in his "Theory of Business Enterprise" expressed the view that the value of an investment basically is a function of future earning power. He said:
"Investments are made for profit, and industrial plants and processes are capitalized on the basis of their profit-yielding capacity."

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"Under the exigencies of the quest of profits, as conditioned by the larger industry and the more sweeping business organization of the last few decades, the question of capital in business has increasingly become a question of capitalization on the basis of earning-capacity, rather than a question of the magnitude of the industrial plant or the cost of production of the appliances of industry. From being a sporadic trait, of doubtful legitimacy, in the old days of the 'natural' and 'money' economy, the rate of profits or earnings on investment has in the nineteenth century come to take the central and dominant place in the economic system."

Williams in his "Theory of Investment Value" has this interesting statement of the theory:
"Separate and distinct things not to be confused, as every thoughtful investor knows, are real worth and market price. No buyer considers all securities equally attractive at their present market prices whatever these prices happen to be; on the contrary, he seeks 'the best at the price.' He picks and chooses among all the stocks and bonds in the market until he finds the cheapest issues. Even then he may not buy at all, for fear that everything is too high and nothing will give him his money's worth. If he does buy, and buy as an investor, he holds for income; if as a speculator, for profit. But speculators as a class can profit only by trading with investors, to whom they can sell only for income; therefore in the end all prices depend on someone's estimate of future income. Of investment value in this sense some men will make one estimate, others another, and of all these estimates only one will coincide with the actual price, and only one with the true worth."

These views of the economists also coincide with the views of the courts. The Supreme Court has insisted on a capitalization of reasonably expected future earnings at an appropriate rate in the light of the business risks of
the particular enterprise as the sole standard of value for the purpose of
corporate reorganization under the Bankruptcy Act. In the Supreme Court's
judgment the value of the securities to be issued by the reorganized enterprise
is to be measured by the degree of their right to participate in the reasonable
estimated future earnings of the enterprise.

This theory of the investment value of securities, I think you will agree,
more precisely defines for both those who administer the Securities Act and thos,
who must comply with it the range of information which is in fact of paramount
material importance. To be sure, the prudent investor should be put in
possession of such facts as the management's ownership of the securities of the
company (which may be an indication of management's own views as to future
earning power); managerial remuneration and other factors such as transactions
between the management and the company which may give an insight as to the
integrity and ability of management. Information on these subjects is in fact
required by the Commission's forms of registration particularly in connection
with new ventures where no earnings record exists. Here, in addition to a
description of the business risks of the proposed venture, it is of importance
to investors to know what degree of participation they will obtain in relation
to their contribution to the venture as against that of the promoters, includin
the existence of such devices as option warrants issued to underwriters and
promoters which may have a substantially diluting effect upon the investor's
future claim to earnings.

Predominantly, however, the material disclosures necessary to appraise
value as against offering price will be disclosures in respect to the earnings
of the company, its financial position, the intended use of the proceeds of the
financing, the nature of the business in which it is engaged and a description
of the contractual rights and participations in assets and earnings of the
securities being offered. In its newest form for registration under the
Securities Act, - a form for the registration of high grade institutional type
non-convertible debt securities, possessing on the basis of past earnings a very
substantial degree of interest coverage, - these areas of information are all
that are required to be included in the registration statement. Moreover, I
think it is a fair statement that over the years the Commission in its form
making has attempted to emphasize these factors in its prospectus requirements
and has reduced materially information not primarily concerned with investment
analysis such as proposed terms of the underwriting, the mechanics of the
proposed distribution of securities and the names and addresses of underwriters.
You will note also that these predominantly important areas of information to which I have referred are also those usually confined to a controller in the management of corporate affairs. That the Act recognizes the paramount materiality of these areas is attested to by the fact that it requires that the registration statement be signed by the issuer's comptroller or principal accounting officer, thus making these officers subject to the civil liabilities of the Act.

For controllers then the important zones of information in respect of the requirements of the Securities Act will be those which are necessary to enable an investor to reach an informed judgment as to the trend of sales and earnings. I will try to discuss some of these areas of information more particularly later in this talk. Before I do that, however, I would like to point out some correlative propositions which flow from the major proposition that investment value is a function of an estimate of the future earnings of the entire enterprise, or the earnings particularly attributable to the security in the enterprise being offered, in each case capitalized at a rate appropriate to the degree of the known risks of its business.
The question will be raised, if the determination of future earnings is the prime task confronting the investor, why not require or permit a direct prediction of such earnings? I believe the answer to this is that the Securities Act like the hero of "Dragnet" is interested exclusively in facts. Conjectures and speculations as to the future are left by the Act to the investor on the theory that he is as competent as anyone to predict the future from the given facts. Since an expert can speak with authority only as to subjects upon which he has professional knowledge and since no engineering course or other professional training has ever been known to qualify anyone as a clairvoyant, attempts by companies to predict future earnings on their own or on the authority of experts have invariably been held by the Commission to be misleading because they suggest to the investor a competence and authority which in fact does not exist. Particularly is this true where the predictions are set forth in the format of an income account. Here an air of authenticity is conveyed which is belied in many cases by the wholly unreasonable assumptions and conjectures upon which it is based, and which, if adequately disclosed, would make the prediction meaningless. I doubt whether many accountants or controllers would wish to certify a prediction of future earnings. Indeed it is a violation of the code of ethics of public accountants for an accountant to lend his name to forecasts of earnings which
might lead prospective investors to undue reliance upon such statements.

Let me also say something about the property of an enterprise and its balance sheet valuation. Fairly frequently attempts are made to file financial statements with the Commission which include write-ups of the book value of fixed assets on the basis of present reproduction costs or fair market value at a recent date. These appraisals the Commission has always considered to be misleading. They are opposed to the generally accepted accounting principle that fixed assets be shown at cost. Accountants wisely adhere to facts. Recorded cost is a fact; value is an opinion which varies with different viewpoints. Moreover these valuations are meaningless if we accept the premise that corporations sell securities to continue in business and not to liquidate. As a corollary, valuations indicating present market value or present replacement costs are of no analytical value since it is not intended to sell the property or to replace it immediately but to use the property to carry on a business as a going concern. The ultimate market value, or replacement costs of the property at the time the company actually liquidates may be a vastly different figure from the appraisal. Indeed, the property may not even exist at that time. Moreover, such appraisals are contrary to the capitalization of future earnings
theory of investment value, which as I have said is held by the great majority of economists, financial analysts and the courts. Bonbright in his "Valuation of Property" states the following in respect to this point:

"It follows from this basic principle of enterprise valuation, that the prospective earnings of a company play a role quite different from that played by other data adduced in proof of the value of the property. These other data, such as the original costs of the separate assets, or estimated replacement costs, or current market prices of outstanding security issues, have no significance whatever, save as a clue to the earnings that may fairly be capitalized. The mere fact that the physical assets of a railroad company, or of a steel company, may actually have cost many million dollars to construct, not only fails to determine the present value of the company -- it has utterly no influence on this value unless, in some indirect way, it may affect the net earnings. And precisely the same statement applies to estimated replacement costs of the physical assets, no less than to historical costs."

I think now you can understand why our forms of registration statements do not require or permit appraisals of the physical property of an enterprise. We
are concerned with the property of the corporation only insofar as disclosures relating to such property bear on the investor's task of estimating future earnings. All that is required by our forms is a statement of the location and general character of the company's property limited to information essential to an investor's appraisal of the securities being registered. In the case of a manufacturing enterprise for example, the form requires the disclosure of property to deal with such overall statements as will reasonably inform investors as to the suitability, adequacy and productive capacity of the facilities needed in the enterprise, with particular reference to the ability of the properties to produce efficiently and competitively.

Of particular importance to Texans, our forms also insist that, in the case of extractive enterprises, appropriate information should be given as to production and reserves. In the case of an extractive enterprise, future earnings and reserves, like matter and energy, ultimately are synonymous. Therefore statements of the physical quantity of unextracted commercial reserves are indispensible to an understanding of the investment merits of securities of extractive industrial companies. In the case of oil and gas companies, this means a statement of reserves appropriately broken down to indicate respectively the quantity of developed and undeveloped reserves, the quantity of heavy cheaper oils, and the
quantity of the more valuable lighter oils, and the estimated costs of future
development of undeveloped proven reserves. The Commission's staff will usually
require informally and not as a part of the registration statement, a presentation
of data which will enable our petroleum engineer to gauge the reasonableness of
the reserve figures and the acceptability of the engineering techniques employed
in arriving at such figures. The same requirement exists for other types of
extractive industries.

To return to my main thesis, if the essential quest of the investor in the
valuation of the securities he is being asked to purchase is an estimate of
future earnings and of the rate at which such earnings should be capitalized,
the financial position and past earnings record of the company are obviously
of prime importance to such an analysis. The analytical utility of this data
is perhaps best epitomized by the maxims appearing on the cornerstones of the
National Archives Building in Washington: "WHAT IS PAST IS PROLOGUE" —
"STUDY THE PAST".

As a corollary, if the past operating results, because of a radical change
in the business of the company or other factors, are without augury for the
future, their inclusion in a registration statement may, in fact, be misleading.
For example, a registration statement was filed by a company which had spent its entire business life in the manufacture of war material during World War II. Immediately after the war, it proposed to raise funds by the sale of common stock in order to engage in the manufacture of fractional horsepower motors—a business in which it had no previous experience. The Commission determined that the company's wartime earnings record was of little value to any estimation of future earnings of the enterprise as reconstituted, and suggested that its past earnings record be omitted from the prospectus. A similar situation occurred recently. A company distributing liquid propane gas at retail was reorganized to engage in the distribution of natural gas. Because of this change in the nature of the business of the company and the fact that its new operations would be substantially extended and subject to rate regulation, the Commission acquiesced in the suggestion of the company itself that its past earnings record would be of little value to the investor and permitted its omission from the registration statement.

The Commission's requirements as to the form and content of financial statements are contained in its Regulation S-X. In general they require such breakdowns of the balance sheet and income accounts as will be meaningful to an
investor. I think you will all agree that the particularized balance sheet required by Regulation S-X, which depicts the nature and character of its current assets and current liabilities; its fixed assets less depreciation; and its investments and other assets perhaps not necessary to the conduct of its actual business operation, is something more than a mere statement of the company's position as of a given date. Appropriately particularized and taken in conjunction with the income accounts, the balance sheet can offer valuable clues as to the recent trend of sales and earnings and possible near term future trends. Needless to say, the staff examines the balance sheet and income accounts for such clues. For example, the balance sheet required by Regulation S-X taken in conjunction with the income accounts and their required accompanying notes may, among other things, supply information in respect of:

(1) The adequacy of the company's working capital to carry on its business at the same levels as it has in the past or at higher levels. A comparison of the company's working capital ratio with that of the industry as a whole can also be made by the investor, thus affording him a valuable insight into the company's relative ability to participate in future sales trends as against that of the industry as a whole. A working capital ratio markedly
inferior to that of the industry in general may well cause the
staff to request a disclosure of this fact in the registration
statement and prospectus.

(2) The presence of assets such as investments in marketable securities
or other property not actually needed in the generation of the past or
future operating profits of the enterprise. These values, of course,
must be added to any valuation derived from a capitalization of extended
future earnings of the company in order to arrive at the actual value
of the securities being offered.

(3) Examination of the level of accounts receivable and inventories as against
the sales of the company up to the date of the financial statements
may give valuable insight as to actual recent past sales trends and
possible future trends. Where the inventories on the balance sheet
compared to the opening and closing inventories for the previous
income periods and recent sales indicate a backing up of demand for one
or more products of the company, appropriate inquiry is suggested. An
instance of this occurred several years ago in the case of a chemical
company. Upon inquiry, the company's registration statement was
amended to disclose the following:
"The Company's inventories of agricultural chemicals presently amount to approximately $4,800,000, which the Company considers about $1,000,000 higher than the inventory which would normally be carried at this time of year. The Company expects to reduce these inventories during the 1953 season for agricultural chemicals, either through an increase in sales or a reduction in production.

At the present time there is general overproduction of agricultural chemicals with attendant price weakness."

(4) The ratio of total depreciation accruals to cost of fixed assets will furnish some indication as to the age and condition of the company's property and may suggest the need of modern and more efficient machinery which might well require the retention of future earnings or the future sale of securities.

(5) The long term debt and capital segments of the liability side of the balance sheet will give an indication of the "leverage" in the junior securities which may effect the future earnings of such securities upward or downward to a greater extent than the actual upward or downward course of the aggregate future earnings of the company. An
example of this may be found in the case of a large investment holding company, a block of the common stock of which was to be offered to the public by insiders. In order to emphasize the negative character of the asset value of the common stock being offered, the following statement was added to the prospectus of that company:

"An increase of $77,663,340 or approximately 100% in the net indicated value of the company's assets before deducting long term debt would be necessary before the net indicated value of such assets applicable to the common stock would be zero, and an increase of $104,798,922, or approximately 135%, would be necessary before the net indicated value of such assets would be equivalent to $6.00 a share [the proposed offering price] for the common stock."

This statement when coupled with the disclosure of the fact that because of the existence of dividend arrearages in excess of $55,000,000 on preferred stocks there was no reasonable expectancy of dividends on the common stock, pointed out the facts needed by the investor in order to compare this enterprise with others of a similar character.
(6) A comparison of net income in the past with the capital section of the balance sheet will give some indication as to the potential rate of return which can be derived from the proceeds the company will receive for the securities which it is offering.

Of even greater utility, perhaps, than the balance sheet in an evaluation of securities by an investor, is the past earnings record of the company as disclosed in appropriately broken down income accounts. As you know, the Commission's requirements for profit and loss statements insist on a particularization which basically includes sales or operating revenues as the case may be; cost of sales or operating expenses; other income; other expenses; taxes and net income. The Commission has insisted on all inclusive income accounts which record all items of profit and loss. However, the income account must be broken down to segregate clearly the operating results of the company as against non-recurring or other special transactions. In 1940 the Commission set forth reasons for the itemization standards that it applied to profit and loss statements in the case of American Sumatra Tobacco Corporation, 7 SEC 1033, 1040 et seq. from which I quote:

"The profit-and-loss statement is designed to disclose for the period selected the amount of net profit or loss, the sources of revenue, and
the nature of expenses. It thereby provides a basis for analyzing the results of operation and the course of the business; and in addition it may be utilized in forecasting the future revenues, expenses and operating results of the enterprise. It is generally agreed among accountants and analysts that in order to perform these functions the statement of profit and loss should show, as a minimum requirement, the dollar volume of commodities or services, the cost of goods sold and operating expenses of the business, income from other sources, income deductions of nonoperating charges, and net profit for the period.

"To particularize, one of the essential purposes of the profit-and-loss statement is to furnish the investor or prospective investor with adequate historical data definitive of past earning power, and of prime importance in forecasting future earning power. In order either to judge the past or to forecast intelligently, an investor must have not only a record of past earnings or losses, but also the significant details as to how the particular results were obtained. The starting point in forecasting earning power is, of course, sales and operating revenues. Moreover, since earning power results from the sale of commodities or services for an amount greater
than the cost of producing or distributing such commodities or services, the next essentials are the cost of goods sold and operating expenses. Similarly, selling and administrative expenses are of prime significance.

If there is made available the historical record of sales, cost of sales and the resultant profit margin, the investor is provided an important guide in calculating future costs in relation to future sales.

"If, however, sales and cost of sales in dollars are not included in the profit-and-loss statement, information essential for analysis is absent. In the first place, there is no possibility of gauging the effect of changes in selling prices, wage rates, material costs and similar items upon the undisclosed primary elements -- sales and revenues, and cost of goods sold -- upon which the profit figure is partially based. Likewise the possibility of gauging the probable effect of such changes upon the resultant profit figure itself becomes less likely. The relationship of the trends of the primary elements from which the resultant profit figure is derived varies under different business and economic conditions. The effects of variations in this relationship cannot be measured by study of the trend of the gross profit on sales or of the net operating profit alone."
"In the second place, the investor is also directly concerned with the relative size of an enterprise's profit margin, since it may be vital in appraising the significance to the particular enterprise of other known factors and trends. A business enterprise may manifest particular efficiency of production, purchasing or distribution; its location, cost of capital, personnel, patents, trade-marks may all be highly favorable. If the factors contributing to the wide profit margin cannot be duplicated, strength may be indicated. But, to the extent that the contributing factors may not be lasting, weakness may be indicated. So a wide profit margin constitutes a warning signal; the investor must determine to what extent the margin is likely to continue. A narrow profit margin may likewise be indicative of strength or weakness. If the narrow profit margin represents the choice of the management to do a large volume of business at prices but little above the cost of production and if this method has resulted in a large scale, integrated, efficient business, the very narrowness of the margin may be an effective barrier to competition. On the other hand a narrow profit margin may be indicative of a variety of causes, such as strong or even destructive competition, managerial inefficiency, increasing prices of raw materials.
relative to selling price. It follows, therefore, that, unless the size
of the profit margin is known to the investor, a vital element of the
information necessary for informed judgment and for this minimum protection
is lacking. Moreover, in either case the extent of fluctuations in sales
and cost of sales is itself an important factor in appraising the degree of
fluctuations in the profit margin.

"In the third place, knowledge of sales is vital also if the quality of
various balance sheet items is to be tested. The comparison of sales to
receivables, inventories, fixed assets and net worth is ordinarily one of
the first steps taken in attempting to appraise the results of operations,
and to predict their future course.

"Unless, in short, an adequate profit-and-loss statement, including
gross sales and cost of sales, is made available, a sound appraisal of the
management is likely to be impossible. Institutional investors and
investment experts, it is true, may on occasion be able to obtain the
necessary information through their own analyses or investigations, even
though it is not contained in the published records. It is possible in
this case, for example, that a skilled analyst, possessing expert and
detailed knowledge respecting the tobacco industry, could on the basis of
the disclosures contained in the nonconfidential portion of the registrant's
financial statements calculate approximately its gross sales and cost of
sales in dollars. Similarly, controlling stockholders may have access to
such information. But the average investor will not have this information
and will not be able to obtain it. As a result, he may well be helpless
in making an adequate estimate of the efficiency with which the management
of the company has conducted the business during the period covered by the
particular profit-and-loss statement, in judging the future trends of the
business, or, in sum, in making a sound decision whether to 'hold, buy or
sell' a security.

"It should not be implied, of course, in our emphasis of the importance
to the investor of the need of an adequate profit-and-loss statement, that
it will automatically give him a perfect and detailed picture of the
operating results that the management is achieving with the enterprise.
If, however, the profit-and-loss statement is adequate, the investor can
form some judgment as to the future. And as financial reporting becomes
increasingly clear and adequate, the more comprehensive will be the analysis which the investor can make of his investment, and the more intelligent will be his investment decisions."

In addition to the required particularization of the income accounts from the viewpoint of investment analysts the Commission's forms also require a sufficient number of consecutive years of profit and loss statements to enable the investor to determine the trend of sales and earnings. The statute itself requires a three year period of profit and loss statements. The Commission, acting under its power to expand the requirements of the statute, now requires a five year summary of earnings included in which may be the statutory three year profit and loss statement. In my own thinking I describe this as an anti-Lord Kylsant requirement. As you know, in 1932 a British court sent Lord Kylsant to jail because his steamship company had issued a prospectus which had truthfully stated its average net income for the past ten years without disclosing the annual income accounts for the period, but had deliberately concealed the fact that its earnings during the first three of the ten years had been greatly augmented by World War I as compared with the seven lean years that followed.
Manifestly, income accounts, the trend of which is belied by sales and earnings subsequent to the fiscal periods required to be presented by the Commission's rules, would be misleading unless the subsequent trend is also disclosed. I recall the case of a prominent tobacco company which offered to rescind an offering of preferred stock to its stockholders after it was discovered that a sharp drop in sales had occurred shortly after the date of the financial statements in the prospectus. If the staff from its industry study or otherwise has reason to believe that such is the case, it may request inclusion in the prospectus of the trend of sales and of the backlog of unfilled orders and the recent rate of receipts of new orders as compared with the past.

Let me discuss more specifically the required data on sales of the company. If the sales are derived from one or more distinct divisions of the company's business, our forms require a breakdown of the aggregate sales derived from each of the specific divisions of the company, if any of such divisions account for 15% or more of the aggregate sales. The registration statement forms also require that the percentage breakdowns of sales by divisions be shown for the period of the summary of earnings. The purpose of this obviously is to highlight the trend of sales of each distinct division of the company's business.
Most companies, in order to illustrate growth tendencies will include in addition to sales figures statistics which indicate production by units of the commodities manufactured over the period of the summary of earnings. For example, operating gas and electric utility companies frequently include statistics illustrating the trend by years of kilowatt consumption as well as the gross revenues derived from important segments of the company's business such as residential, commercial or industrial services. Oil producing companies illustrate their growth in terms of barrels of oil produced by years over the period of the summary of earnings. In some cases they also indicate their exploratory activities in terms of the number of wells drilled in the periods covered by the required summary of earnings and the results of such drilling. If the growth of dollar sales or revenues over the period of the summary of earnings is not accompanied by a growth of production in units of commodities produced or services rendered but predominantly represents price increases, disclosure of the relative movement of dollar sales as against production of commodities manufactured should be made.

Finally let me discuss briefly the requirements of the Commission's forms in respect of a description of the business of the registered company. Our require-
ments synchronize the description of the business with the financial statements, in that the description must include a statement of the development of the business over the preceding five years included in the summary of earnings.

Essentially the purpose of this description is to depict the risks of the enterprise and not to obtain a description of manufacturing procedures and other technological matters. What is desired are statements which will illuminate, among other things, the following:

(1) the product manufactured, its utility and the relative sensitivity of production and sales to cyclical economic change;

(2) the range of demand for the product among (a) other manufacturers and (b) ultimate consumers;

(3) the existence of competing products or services and the relative acceptance of such products or services as against those manufactured or prepared by the company;

(4) the existence of new technologies or of new products and services which may make the company's products or services obsolete. For example, a company manufacturing forged axles for railroad freight cars was required to include in its registration statement that the
American Association of Railroads had approved a hollow steel axle of equal tensile strength but lighter in weight than forged axles, an important factor in the selection of axles for freight cars;

(5) the dependence of the company upon one customer or relatively few customers such as the United States government, if the company's business is primarily defense connected;

(6) the patent or other protection which the company has for its products and the possibility of more intense competition if and when such patent protection expires;

(7) the competitive position of the company in its industry with particular emphasis upon the ratio of its production and sales to the total production and sales of the industry as a whole. In respect of this latter point, if the trends of sales and profit margins indicated by the summary of earnings is substantially inferior to the average trend of the industry as a whole, disclosure on this point may be required in the prospectus and registration statement.

In short it is the function of the description of the business to indicate as clearly as possible those elements of risk in the business which may be
relevant in determining the appropriate rate at which the estimated future earnings of the business should be capitalized in the light of both its position in its own industry and the possible availability for investment of other issues offering greater return with less risk.

I have tried in the brief time available to me to give you some idea of the functions and purposes of the registration statement and prospectus under the Securities Act. I have tried to indicate to you major areas of inquiry concerning which the staff may seek information in its attempt to see that material facts are presented to investors. However, I must again stress strongly that the inspection of the registration statement and prospectus which I have described cannot be exhaustive and most certainly cannot guarantee the accuracy of the facts in the registration statement or assure that nothing material has been omitted. That responsibility the statute places on those who are obviously in possession of far more pertinent information about the company than the Commission and its staff. I have already read to you the statute's trictures on representing that our inspection is any guaranty of accuracy or completeness.