The Difference Between "Reported" and "Hidden" Items in Core Earnings

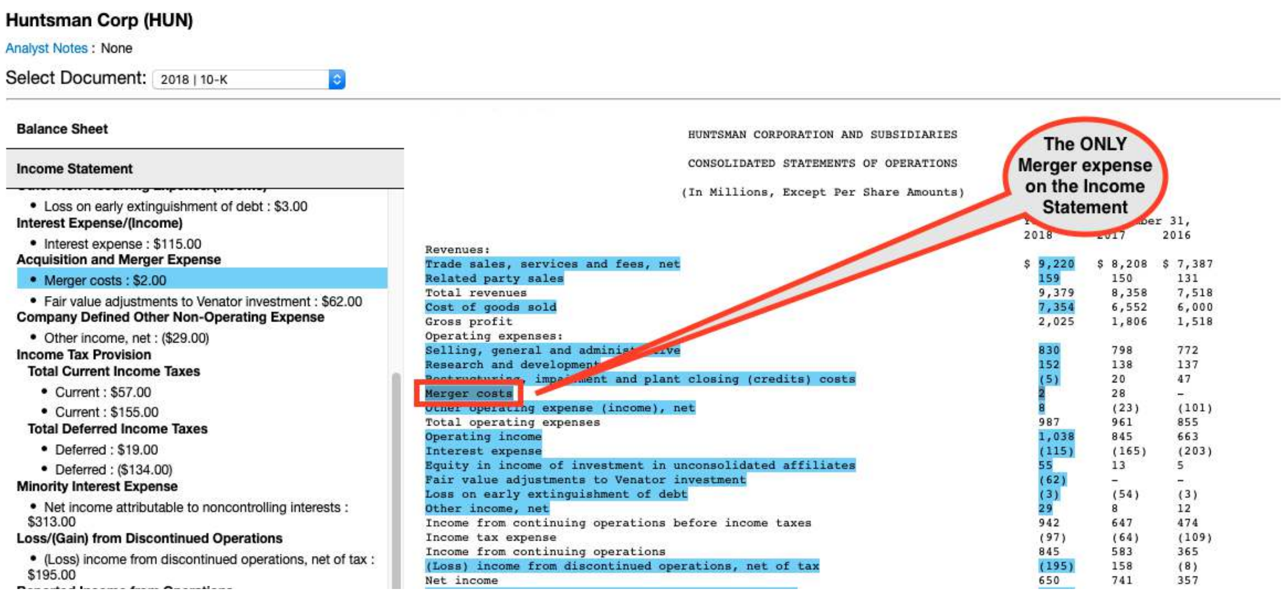
The purpose of measuring core earnings is to assess the normalized operating profitability of a business. Accordingly, analysts should strip out any gains/losses that are non-core, non-operating, or unusual when calculating core earnings[1].

We divide the unusual gains/losses that we strip out of core earnings into two major categories:

1. "Reported" unusual gains/losses are disclosed on the income statement.
2. "Hidden" unusual gains/losses are disclosed **only** in the footnotes or MD&A. One cannot find them on the income statement because they are bundled inside of another item reported on the income statement such as SG&A or Cost of Goods Sold.

For an example of a "reported" unusual item, see the $2 million of Merger Costs on the income statement in the Huntsman Corp (HUN) 2018 10-K in Figure 1.

Figure 1: Huntsman Corp (HUN) Merger Costs Reported on the Income Statement



Huntsman Corp (HUN)
Analyst Notes : None
Select Document: 2018 | 10-K

Balance Sheet
Income Statement

- Loss on early extinguishment of debt : $3.00

Interest Expense/(Income)
- Interest expense : $115.00

Acquisition and Merger Expense
- Merger costs : $2.00
- Fair value adjustments to Venator investment : $62.00

Company Defined Other Non-Operating Expense
- Other income, net : ($29.00)

Income Tax Provision
Total Current Income Taxes
- Current : $57.00
- Current : $155.00

Total Deferred Income Taxes
- Deferred : $19.00
- Deferred : ($134.00)

Minority Interest Expense
- Net income attributable to noncontrolling interests : $313.00

Loss/(Gain) from Discontinued Operations
- (Loss) income from discontinued operations, net of tax : $195.00

HUNTSMAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Millions, Except Per Share Amounts)

	2018	2017	2016
Revenues:			
Trade sales, services and fees, net	$ 9,220	$ 8,208	$ 7,387
Related party sales	159	150	131
Total revenues	9,379	8,358	7,518
Cost of goods sold	7,354	6,552	6,000
Gross profit	2,025	1,806	1,518
Operating expenses:			
Selling, general and administrative	830	798	772
Research and development	152	138	137
Restructuring, impairment and plant closing (credits) costs	(5)	20	47
Merger costs	2	28	–
Other operating expense (income), net	8	(23)	(101)
Total operating expenses	987	961	855
Operating income	1,038	845	663
Interest expense	(115)	(165)	(203)
Equity in income of investment in unconsolidated affiliates	55	13	5
Fair value adjustments to Venator investment	(62)	–	–
Loss on early extinguishment of debt	(3)	(54)	(3)
Other income, net	29	8	12
Income from continuing operations before income taxes	942	647	474
Income tax expense	(97)	(64)	(109)
Income from continuing operations	845	583	365
(Loss) income from discontinued operations, net of tax	(195)	158	(8)
Net income	650	741	357

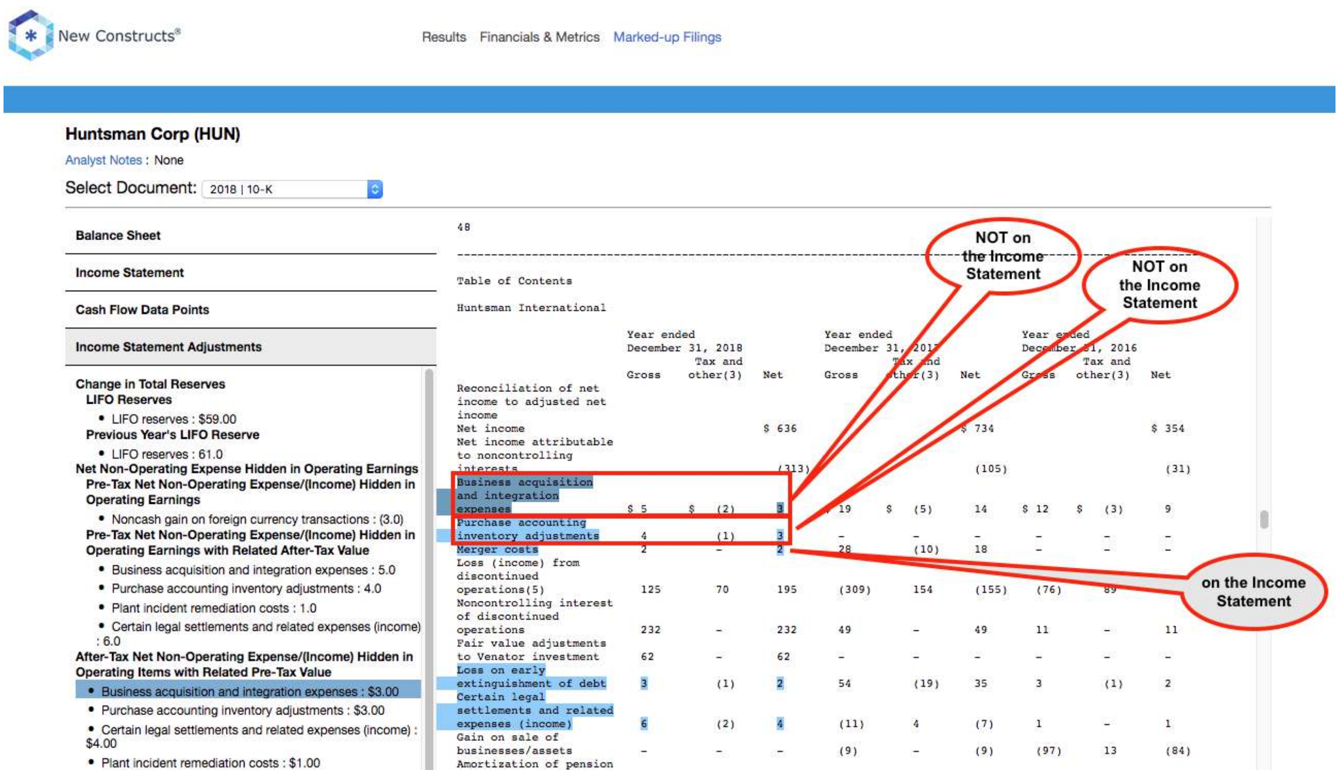
Sources: New Constructs, LLC and company filings

For an example of "hidden" unusual items, see the additional merger-related costs in the footnotes (page F-49) of the 2018 10-K in Figure 2.

- $3 million of "Business acquisition and integration expenses" and
- $3 million of "Purchase accounting inventory adjustments

[1] In Core Earnings: New Data & Evidence, professors from Harvard Business School (HBS) & MIT Sloan show that stripping out unusual items has become increasingly difficult. So difficult, in fact, that most analysts are not doing it, and, as a result, markets inefficiently measure core earnings. The professors also show that our "novel dataset" of footnotes disclosures enables analysts to strip out the unusual items that distort core earnings measures from traditional sources, such as CompuStat and the street.

Figure 2: Huntsman Corp (HUN) Merger Costs Hidden in the Footnotes



Sources: New Constructs, LLC and company filings

If an item appears on both the income statement and the footnotes, as does the $2 million of "Merger Costs" in Figures 1 and 2, we consider it "reported". Hidden items are truly hidden and available only from footnotes or MD&A research.

Most of the time line items called "Other" on the income statement bundle both usual and unusual items. If we find an unusual item bundled in the footnote breakout of "Other", we classify it as "reported."

The pictures in Figures 1 and 2 come from the Marked-Up filings section of our Company Models, which shows clients exactly where every data point used in our models appears in the original financial filings.

For more information on our calculation of core earnings, including details on all the hidden and reported items we collect, click here.

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Disclosure: David Trainer, Kyle Guske II, and Sam McBride receive no compensation to write about any specific stock, style, or theme.

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Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

HBS & MIT Sloan research reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies (featured by Harvard Business School), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Learn more.

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

"…the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications." – page 20

Pick better stocks:

"Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year." – Abstract

Avoid losses from using other firms' data:

"…many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat…" – page 14

Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

"An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A." – page 33-34

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