Earnings Distortion Scorecard: Week of 1/20/20-1/24/20

For the week of 1/20/20-1/24/20, we focus on the Earnings Distortion scores for 55 companies.

We measure earnings distortion using a proprietary human-assisted machine learning methodology featured in a recent paper from Harvard Business School (HBS) and MIT Sloan. This paper shows that street earnings estimates are incomplete and less accurate since they do not adjust for unusual gains/losses buried in footnotes.

Get the best fundamental research

As corporate managers bury key data in footnotes to manipulate earnings, and investors miss them, investment opportunities arise because stock prices tend to be driven by core earnings power.

Our Earnings Distortion Scores[1] empower investors to combat management efforts to obfuscate financial performance. The aggregate level of distortion recently reached heights not seen since right before the tech bubble and the financial crisis.

Weekly Earnings Distortion Insights

Figure 1 contains the 15 largest S&P 500 companies, plus those with market caps greater than $10 billion, that we expect to beat or miss earnings expectations the week of January 20, 2020.

Figure 1: Earnings Distortion Scorecard Highlights: Week of 1/20/20-1/24/20

Company	Ticker	EPS Estimate	Earnings Date	Earnings Distortion Score
IBM	IBM	$4.68	1/21/20	Beat
Johnson & Johnson	JNJ	$1.87	1/22/20	Beat
Texas Instruments	TXN	$1.01	1/22/20	Miss
Prologis	PLD	$0.38	1/22/20	Miss
Crown Castle International	CCI	$0.47	1/22/20	Beat
Las Vegas Sands	LVS	$0.78	1/22/20	Miss
Netflix	NFLX	$0.52	1/22/20	Miss
Procter & Gamble	PG	$1.37	1/23/20	Strong Beat
Intel	INTC	$1.25	1/23/20	Miss
Comcast	CMCSA	$0.76	1/23/20	Miss
Union Pacific	UNP	$2.15	1/23/20	Miss
Intuitive Surgical	ISRG	$3.35	1/23/20	Miss
Norfolk Southern	NSC	$2.39	1/23/20	Miss
AbbVie	ABBV	$2.20	1/24/20	Beat
NextEra Energy	NEE	$1.47	1/24/20	Miss

Sources: New Constructs, LLC and company filings

The appendix to this report shows all the S&P 500 companies, plus those with market caps greater than $10 billion, that report earnings the week of January 20, 2020.

[1] Note that Earnings Distortion scores will be added to our website via a new column on the Screeners and Portfolios page in January 2020.

Details: PG's Earnings Distortion

Over the trailing twelve months (TTM) period, Procter & Gamble (PG: $124/share) had -$7.4 billion in net earnings distortion that cause earnings to be understated. Notable unusual expenses buried in the fine print of the firm's 2019 10-K include:

- $8.3 billion in goodwill impairment charges, $8 billion after-tax – Page 35 and Page 44
- $754 million in restructuring expense – Page 45

The pre-tax value for the impairment charge was disclosed directly on the income statement, but the after-tax value could only be found by reading through the footnotes.

These unusual expenses were offset by some non-operating income items, most notably a $353 million after-tax gain on the sale of assets (Page 12).

In total, we identified $2.91/share (184% of reported EPS) in net unusual expenses in PG's TTM results. After removing this earnings distortion from GAAP net income, we see that PG's TTM core earnings of $4.49/share are significantly above its GAAP EPS of $1.58.

The analyst consensus for PG's Q2 earnings is $1.37/share. Investors who only look at GAAP net income will think that analysts are projecting PG to earn almost as much this quarter as it did in the entire previous year. By removing earnings distortion, we see that consensus estimates imply much more modest annualized year-over-year growth of 22%, compared to the 247% growth implied by the unadjusted numbers for Q2. See Figure 2.

Figure 2: PG Core Earnings Vs. GAAP: 2016-Q2 2020
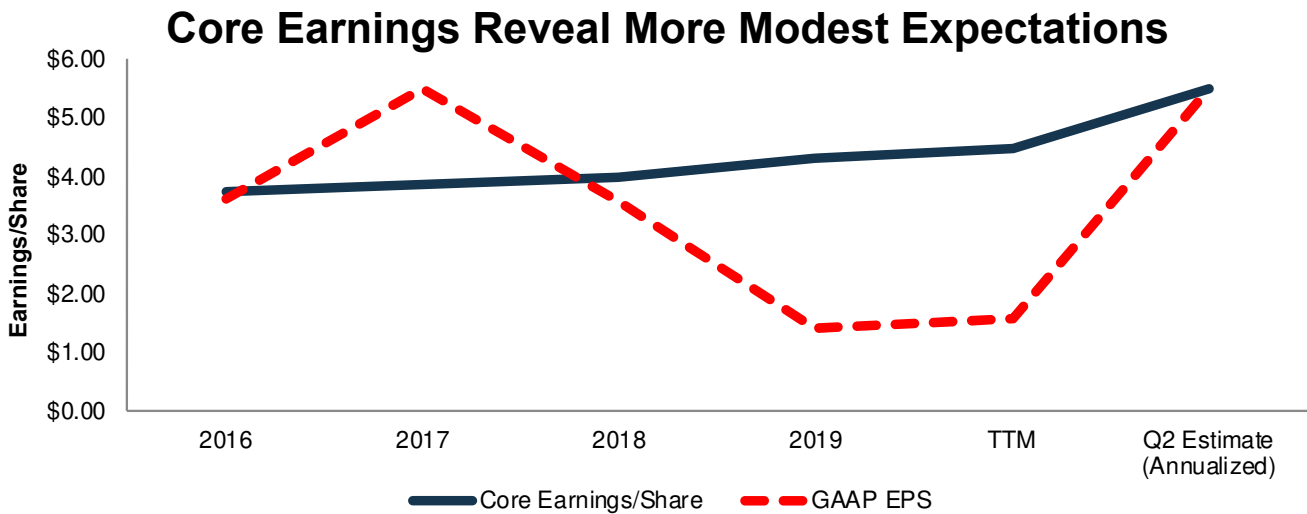
Sources: New Constructs, LLC and company filings

Figure 1 shows that PG is the only company to earn our "Strong Beat" rating for the week of 1/20/20. Four other companies earn our "Beat" rating, which means we think they will beat expectations, but we're not as confident as we are with PG. 10 companies in Figure 1 earn a "Miss" rating.

How to Make Money with Earnings Distortion Data

"Trading strategies that exploit {adjustments provided by New Constructs} produce abnormal returns of 7-to-10% per year." – Page 1 in Core Earnings: New Data & Evidence

In Section 4.3 of Core Earnings: New Data and Evidence, professors from HBS & MIT Sloan present a long/short strategy that holds the stocks with the most understated EPS and shorts the stocks with the most overstated earnings. Positions are opened in the month each 10-K is filed and held until the next 10-K is filed, or about a year.

This simple, low turnover strategy produced abnormal returns of 7-to-10% a year. These abnormal returns show that the market misses important data in the footnotes and that investors who adjust for unusual items can make more money. Click here for more details on our data offerings.

For more on how to use core earnings and earnings distortion to pick better stocks, click here.

This article originally published on January 13, 2020.

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

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Appendix: All Major Companies That Report January 20-24

Figure 3 shows all the S&P 500 companies, plus those with market caps greater than $10 billion, that report earnings the week of January 20, 2020.

Figure 3: Earnings Distortion Scorecard: Week of 1/20/20-1/24/20

Company	Ticker	EPS Estimate	Earnings Date	Earnings Distortion Score
New Oriental Education	EDU	$0.20	1/20/20	In-Line
TD Ameritrade Holding Corp	AMTD	$0.75	1/20/20	In-Line
Zions Bancorp	ZION	$1.08	1/20/20	In-Line
Capital One Financial Corp	COF	$2.29	1/21/20	In-Line
Citrix Systems, Inc.	CTXS	$1.68	1/21/20	Strong Miss
Comerica Inc.	CMA	$1.75	1/21/20	In-Line
F5 Networks Inc	FFIV	$2.43	1/21/20	Miss
Halliburton Company	HAL	$0.29	1/21/20	In-Line
IBM	IBM	$4.69	1/21/20	Beat
Lam Research Corp	LRCX	$3.84	1/21/20	Beat
Las Vegas Sands Corp	LVS	$0.78	1/21/20	Miss
Northern Trust Corp	NTRS	$1.73	1/21/20	In-Line
Rollins Inc.	ROL	$0.17	1/21/20	Beat
SL Green Realty Corp	SLG	$0.39	1/21/20	Miss
TAL Education Group	TAL	$0.09	1/21/20	In-Line
TE Connectivity Ltd	TEL	$1.14	1/21/20	In-Line
Teledyne Technologies, Inc.	TDY	$2.74	1/21/20	In-Line
Teradyne Inc.	TER	$0.79	1/21/20	Strong Miss
United Technologies Corp	UTX	$1.84	1/21/20	In-Line
Waters Corporation	WAT	$3.01	1/21/20	Beat
Abbott Laboratories	ABT	$0.94	1/22/20	In-Line
Alaska Air Group, Inc.	ALK	$1.39	1/22/20	In-Line
Ally Financial Inc	ALLY	$0.93	1/22/20	In-Line
American Airlines Group Inc	AAL	$1.27	1/22/20	In-Line
American Electric Power	AEP	$0.60	1/22/20	Miss
Amphenol Corporation	APH	$0.91	1/22/20	In-Line
Baker Hughes Co	BKR	$0.31	1/22/20	In-Line
E*TRADE Financial Corp	ETFC	$0.82	1/22/20	In-Line
Johnson & Johnson	JNJ	$1.87	1/22/20	Beat
Netflix Inc.	NFLX	$0.52	1/22/20	Miss
Prologis Inc.	PLD	$0.38	1/22/20	Miss
Raymond James Financial, Inc.	RJF	$1.93	1/22/20	In-Line
ResMed Inc.	RMD	$1.03	1/22/20	Beat
Texas Instruments, Inc.	TXN	$1.01	1/22/20	Miss

Sources: New Constructs, LLC and company filings

Figure 3: Earnings Distortion Scorecard: Week of 1/20/20-1/24/20 (continued)

Company	Ticker	EPS Estimate	Earnings Date	Earnings Distortion Score
Western Digital Corp	WDC	$0.57	1/22/20	Beat
AbbVie, Inc.	ABBV	$2.20	1/23/20	Beat
Air Products & Chemicals, Inc.	APD	$2.10	1/23/20	In-Line
Colgate-Palmolive Company	CL	-$0.06	1/23/20	In-Line
Comcast Corporation	CMCSA	$0.76	1/23/20	Miss
Discover Financial Services	DFS	$2.24	1/23/20	In-Line
Freeport-McMoRan Inc.	FCX	$0.00	1/23/20	Miss
Intel Corporation	INTC	$1.25	1/23/20	Miss
Intuitive Surgical, Inc.	ISRG	$3.34	1/23/20	Miss
KeyCorp	KEY	$0.48	1/23/20	In-Line
Kimberly-Clark Corp	KMB	$1.69	1/23/20	In-Line
M&T Bank Corp	MTB	$3.48	1/23/20	In-Line
NextEra Energy, Inc.	NEE	$1.47	1/23/20	Miss
NVR Inc.	NVR	$58.69	1/23/20	Miss
Procter & Gamble Co.	PG	$1.37	1/23/20	Strong Beat
Southwest Airlines Company	LUV	$1.11	1/23/20	In-Line
SVB Financial Group	SIVB	$4.70	1/23/20	In-Line
The Travelers Companies, Inc.	TRV	$3.20	1/23/20	In-Line
Union Pacific Corp	UNP	$2.11	1/23/20	Miss
American Express Company	AXP	$2.02	1/24/20	In-Line
Synchrony Financial	SYF	$1.06	1/24/20	In-Line

Sources: New Constructs, LLC and company filings

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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