This Industrials Firm's Acquisition Has Not Created Shareholder Value

Our latest featured stock is an industrial gas company with distorted GAAP net income due to the impact of a recent acquisition. Last week, we analyzed 501 10-Ks and 10-Qs.

Get the best fundamental research

Analyst Robert Hicks found an unusual item in Linde, PLC's (LIN) 2019 10-K.

On Page 19, LIN discloses $2.0 billion in unusual expenses hidden in GAAP net income. These expenses stem from the purchase accounting impact of the merger between Praxair and Linde AG in October 2018. After adjusting for all hidden and reported items, we find that LIN's core earnings[1] were $3.9 billion in 2019 compared to GAAP net income of $2.3 billion.

While the merger increased LIN's core earnings from $1.8 billion in 2018 to $3.9 billion in 2019, it has failed to create true shareholder value given the purchase price. LIN's invested capital increased from $23 billion in the year before the merger to $81 billion in 2019. As a result of invested capital nearly quadrupling, while profits only doubled, the company's return on invested capital (ROIC) fell from 8% the year before the merger to 5% in 2019. LIN has yet to realize the "anticipated annual synergies and cost reductions" in a way that creates shareholder value.

Figure 1: LIN's ROIC Since Acquiring Praxair in 2018

LIN's ROIC Falls Since Praxair Acquisition
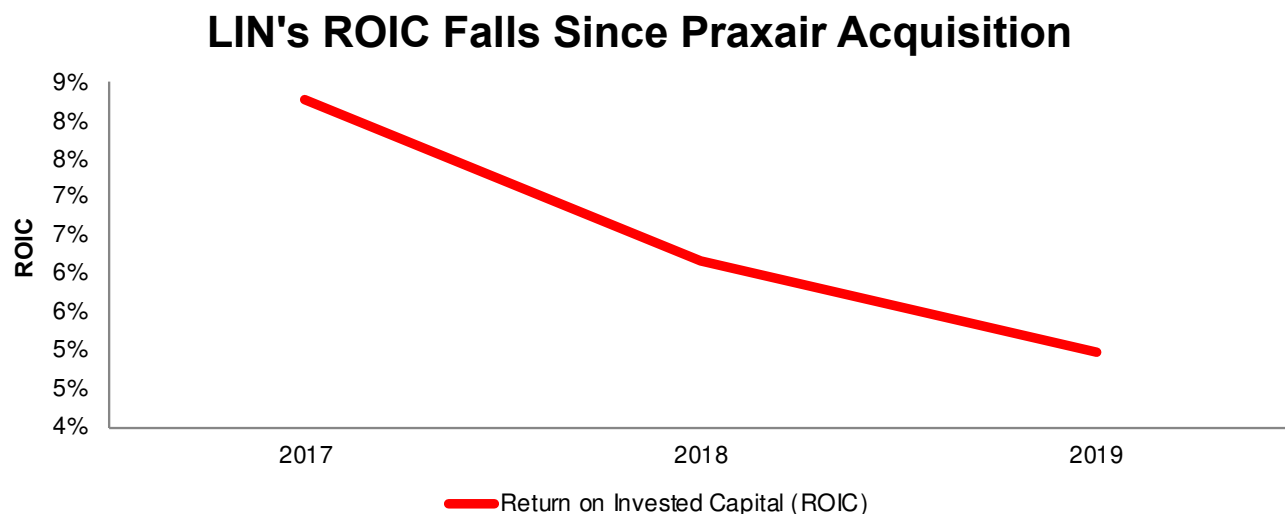
Sources: New Constructs, LLC and company filings

LIN's understated earnings in 2019 earn the stock our "Beat" Earnings Distortion Score (as featured on CNBC Squawk Box), which means LIN is more likely to beat consensus expectations. Despite the likelihood to beat expectations in the short-term, LIN's low ROIC and expensive stock means the stock earns our Unattractive Risk/Reward rating. In other words, the stock does not represent attractive risk/reward over the long-term.

[1] Our Core earnings are a superior measure of profits, as demonstrated in In Core Earnings: New Data & Evidence a paper by professors at Harvard Business School (HBS) & MIT Sloan. The paper empirically shows that our data is superior to IBES "Street Earnings", owned by Blackstone (BX) and Thomson Reuters (TRI), and "Income Before Special Items" from Compustat, owned by S&P Global (SPGI).

Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.

Other Critical Details on LIN Found by Our Robo-Analyst Technology

Balance Sheet: we made $12.6 billion of adjustments to calculate invested capital with a net increase of $7.1 billion. One of the most notable adjustments was $4.8 billion (6% of reported net assets) in other comprehensive income. See all adjustments to LIN's balance sheet here.

Valuation: we made $29.5 billion of adjustments with a net effect of decreasing shareholder value by $24.9 billion. Apart from $15 billion in total debt, which includes operating leases, the most notable adjustment to shareholder value was $6.6 billion in deferred tax liabilities. This adjustment represents 6% of LIN's market cap. See all adjustments to LIN's valuation here.

The Power of the Robo-Analyst

We analyzed 501 10-K and 10-Q filings last week, from which our Robo-Analyst[2] technology collected 55,615 data points. Our analyst team made 9,915 forensic accounting adjustments with a dollar value of $2.9 trillion. The adjustments were applied as follows:

- 3,482 income statement adjustments with a total value of $164 billion
- 4,342 balance sheet adjustments with a total value of $1.1 trillion
- 2,091 valuation adjustments with a total value of $1.6 trillion

Figure 2: Filing Season Diligence for the Week of March 2 – March 8

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments ($Billions)
Filing Season Week 3	501	55,615	9,915	$2,786
Filing Season Total	1,375	156,209	27,103	$14,731

Sources: New Constructs, LLC and company filings.

Every year in this six-week stretch from mid-February through the end of March, we parse and analyze roughly 2,000 10-Ks to update our models for companies with 12/31 and 1/31 fiscal year ends. This effort is made possible by the combination of expertly trained human analysts with our "Robo-Analyst." Featured by Bloomberg and Harvard Business School in "Disrupting Fundamental Analysis with Robo-Analysts", our research automation technology uses machine learning and natural language processing to automate and improve financial modeling.

No Substitute for Diligence on Fundamentals

Our technology enables us to deliver diligence on fundamentals at a previously impossible scale. We believe this research is necessary to uncover the true profitability of a firm and make sound investment decisions. "Core Earnings: New Data and Evidence," a recent paper from professors at Harvard Business School and MIT Sloan, shows how our adjustments create a measure of core earnings that is more predictive of future earnings than comparable metrics from Compustat and IBES.

Only by reading through the footnotes and making adjustments to reverse accounting distortions can investors and advisors alike get beyond the noise and get the truth about earnings and valuation.

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Disclosure: David Trainer, Robert Hicks, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

Follow us on Twitter (#filingseasonfinds), Facebook, LinkedIn, and StockTwits for real-time alerts on all our research.

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[2] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.

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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