



## Don't Chase Growth with This Overvalued Tech Stock

Check out this week's [Danger Zone interview](#) with Chuck Jaffe of [Money Life](#).

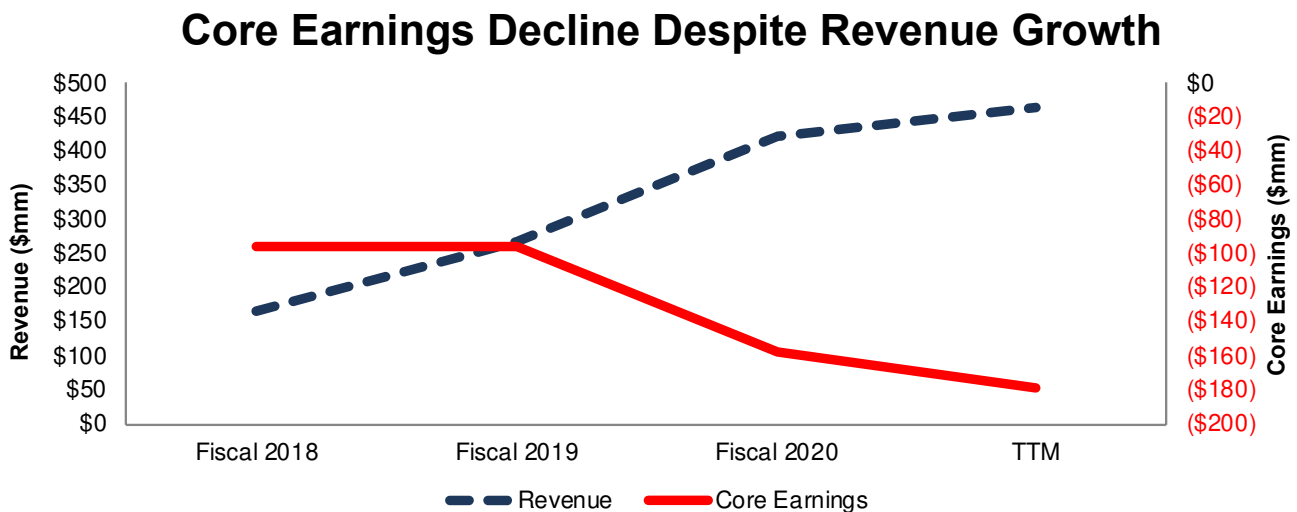
Investors love a growth story, especially one that ties into common buzzwords such as “cloud” or the numerous different iterations of “as-a-service.” This high-flying company is seeing declining revenue growth rates but rising costs amidst an industry filled with competition. However, its stock price implies it will drastically improve margins while also growing revenue faster than consensus and management’s own expectations. Avoid MongoDB (MDB: \$226/share), which is this week’s [Danger Zone](#) pick.

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### MongoDB’s Profitless Revenue Growth

From fiscal 2018-2020, MongoDB has grown revenue by an impressive 65% compounded annually. Meanwhile, [core earnings](#)<sup>1</sup> declined from -\$96 million to -\$158 million over the same time, per Figure 1. Core earnings have fallen even further, to -\$178 million, over the trailing-twelve-month (TTM) period.

**Figure 1: MDB’s Revenue Growth Vs. Core Earnings Decline**



Sources: New Constructs, LLC and company filings.

MongoDB’s declining profits lead to significant free cash flow (FCF) burn in each of the past two years and the TTM period. In fiscal 2019 and 2020, MongoDB burned a cumulative \$980 million in FCF. The firm’s -\$698 million FCF over the TTM period equates to a -5% [FCF yield](#), which is significantly lower than the Technology sector average of 1%. MongoDB could sustain its TTM cash burn for just under a year and a half before needing additional capital. With significant competition, MongoDB may be hard pressed to reverse its cash burn as it must continually invest in its product to remain competitive with much larger tech giants.

### Non-GAAP Metrics Further Mislead Investors

As with many unprofitable companies, MongoDB would rather investors focus on [flawed non-GAAP metrics](#) such as non-GAAP gross profit, non-GAAP loss from operations, and non-GAAP net loss. In a [recent Harvard Business School and MIT Sloan paper](#), experts show that “Street Earnings are not only an incomplete reflection

<sup>1</sup> Our core earnings are a superior measure of profits, as demonstrated 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 “Operating Income After Depreciation” and “Income Before Special Items” from Compustat, owned by S&P Global (SPGI).

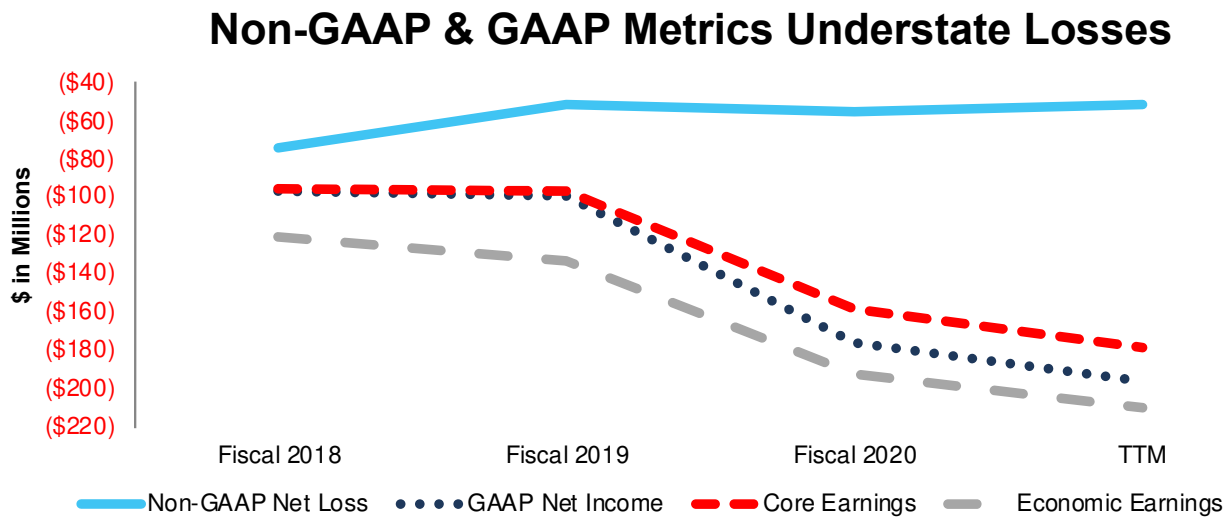


of firms' non-operating earnings but also reflect managerial biases". If you think non-GAAP metrics are any better, you're mistaken.

Among the items MongoDB excludes when calculating its non-GAAP metrics are stock-based compensation expense, acquisition costs, amortization of acquired intangible assets, and more.

In the TTM period, MongoDB removed \$92 million (20% of revenue) in stock-based compensation when calculating its non-GAAP net loss. Per Figure 2, MongoDB's TTM non-GAAP net loss of \$51 million is well above GAAP net income of -\$196 million. Economic earnings, which account for the unusual items on the income statement and changes to the balance sheet, are much lower, at -\$210 million, and trending in the opposite direction of non-GAAP net losses.

Figure 2: MDB's Non-GAAP Net Loss & GAAP Net Income Are Misleading



Sources: New Constructs, LLC and company filings.

### Freemium Offering Is Not Converting Enough Paying Customers

To encourage usage, familiarity, and adoption of its platform, MongoDB provides its Community Server as a freemium offering. The idea behind any freemium offering is to attract potential customers to the platform and then upsell them to a paid version that offers more robust features and capabilities. However, MongoDB's freemium offering is not achieving its intended results.

The firm notes in its fiscal 1Q21 10-Q that its Community Server has been downloaded over 110 million times since February 2009 and over 40 million times in the last 12 months. However, MDB's customer count pales in comparison to the number of downloads. At the end of fiscal 1Q21 (period ended April 30, 2020), MDB notes it had over 18,400 customers, which was up from 14,200 in fiscal 1Q20. In other words, while Community Server was downloaded over 40 million times, MongoDB added just 4,200 new customers, a conversion rate of just 0.01%.

### Native Cloud Offerings Present Obstacles to Growth

Research from Gartner notes the majority of database management growth is in the cloud, on cloud platforms such as Amazon Web Services (AWS) and Microsoft (MSFT). These two firms, with their vast resources, also represent a significant portion of the entire market. Gartner estimates that AWS and Microsoft accounted for 76% of the growth in the database management system market in 2018.

Many cloud platforms have their own database management software (such as Microsoft SQL server) which is directly integrated with Microsoft's cloud offering. Furthermore, competing firms offer additional services, such as customer relationship management platforms that help build out an entire suite of enterprise software. Most importantly, these competitors can offer their products at low, or even no cost, to enhance the overall value of the cloud platform. Competing firms can also bundle the other services to create a comprehensive solution that MongoDB cannot, as they're simply one piece of an enterprise's software needs.



**Lagging Profitability Limits Ability to Improve Profitability**

Not only does MongoDB compete with large tech firms with ample resources and vast product offerings (such as AWS Dynamo DB, Microsoft Azure Cosmos DB, or Oracle NoSQL Database), the non-relational database market is filled with other competitors. Alternatives include Couchbase, Casandra, PostgreSQL, IBM Cloudant, RavenDB, Altibase, and many more.

DB-Engine, which measures the [popularity of database management platforms](#) ranks MongoDB fifth, behind Oracle, MySQL (owned by Oracle), Microsoft SQL Server, and PostgreSQL (a free and open-source database management system).

Below, we analyze MongoDB’s profitability vs. its listed competitors (in its fiscal 2020 10-K), Microsoft, Oracle (ORCL), Alphabet (GOOGL), International Business Machines (IBM), Amazon.com (AMZN) and the market-cap-weighted average of the Software firms under coverage. Per Figure 3, MongoDB’s -34% NOPAT margin is well below the industry market-cap-weighted average of 18% and even further below each of its direct competitor’s margins.

**Figure 3: MDB’s NOPAT Margin Vs. Competition & Industry Peers**

Company	Ticker	NOPAT Margin
Microsoft Corporation	MSFT	32%
Oracle Corporation	ORCL	31%
Alphabet, Inc.	GOOGL	19%
International Business Machines	IBM	11%
Amazon.com Inc.	AMZN	5%
MongoDB Inc.	MDB	-34%
Software Firms’ Market-Cap-Weighted Average		18%

Sources: New Constructs, LLC and company filings.

MongoDB’s capital efficiency is also below the industry average and most of its competition. Per Figure 4, MongoDB’s [invested capital turns](#), are less than one-fourth the industry average.

**Figure 4: MDB’s Invested Capital Turns Vs. Competition & Industry Peers**

Company	Ticker	Invested Capital Turns
Amazon.com Inc.	AMZN	2.66
Alphabet, Inc.	GOOGL	1.69
Microsoft Corporation	MSFT	1.22
Oracle Corporation	ORCL	0.66
MongoDB Inc.	MDB	0.61
International Business Machines	IBM	0.51
Software Firms’ Market-Cap-Weighted Average		2.33

Sources: New Constructs, LLC and company filings.

The combination of low margins and capital inefficiency drives MongoDB’s negative return on invested capital ([ROIC](#)) Per Figure 5, MongoDB’s ROIC of -21% is well below the industry average and competition. Even worse, MongoDB’s ROIC declined from -20% in fiscal 2019, which indicates the firm’s profitability is trending in the wrong direction.



**Figure 5: MDB's ROIC Vs. Competition & Industry Peers**

Company	Ticker	Return on Invested Capital (ROIC)
Microsoft Corporation	MSFT	39%
Alphabet, Inc.	GOOGL	33%
Oracle Corporation	ORCL	20%
Amazon.com Inc.	AMZN	12%
International Business Machines	IBM	6%
MongoDB Inc.	MDB	-20%
Software Firms' Market-Cap-Weighted Average		27%

Sources: New Constructs, LLC and company filings.

It is much easier to achieve impressive revenue growth rates when operating with a -34% NOPAT margin and -20% ROIC. However, in order to buy into the firm's lofty valuation, one must believe the firm can "flip the switch" of profitability, maintain rapid growth rates, and take share from industry incumbents and newcomers alike. As we'll show below, all three occurring at the same time seems unlikely.

**Fundamentals Don't Support Bull Case**

Despite the large (and deep-pocketed) competition, and MongoDB's lack of profitability, bulls will argue that MongoDB simply needs to "achieve scale" to showcase the strong profitability implied by its lofty valuation. Unfortunately, the scale argument doesn't ring true when MongoDB's revenue growth is already slowing while its costs are growing year-over-year (YoY) and aren't expected to stop anytime soon.

**Significant Decline in Revenue Growth**

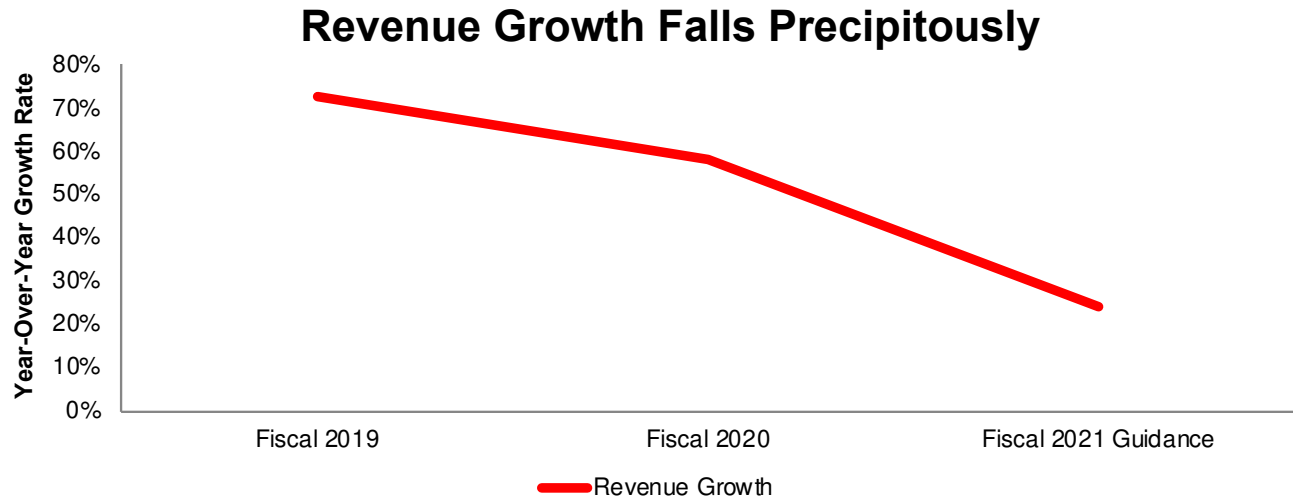
Optimism for MongoDB has been driven by the firm's rapidly growing revenue and has largely overlooked its rapidly growing losses. However, in fiscal 2020, revenue grew 58% YoY, which was actually down from 73% YoY in fiscal 2019 and could foreshadow a new trend.

In fiscal 2021, investors should expect MongoDB's revenue growth to fall even further. The midpoint of management's latest fiscal 2021 revenue guidance (provided in its fiscal 1Q21 earnings release), implies a YoY revenue growth rate of 24%, or less than half the YoY growth rate in fiscal 2020.

Such a decline in revenue is not only related to the COVID-19 pandemic, either. In its fiscal 4Q20 earnings call, management had previously estimated the impacts of COVID-19 on its full-year revenue. If we were to remove this impact, the implied revenue growth rate would still be just 28% YoY in fiscal 2021, well below prior years' growth rates. Significantly lower revenue growth does not match the high-flying growth story from MongoDB bulls.



Figure 6: MDB's Revenue Growth Rate Is Expected to Decline Significantly in Fiscal 2021



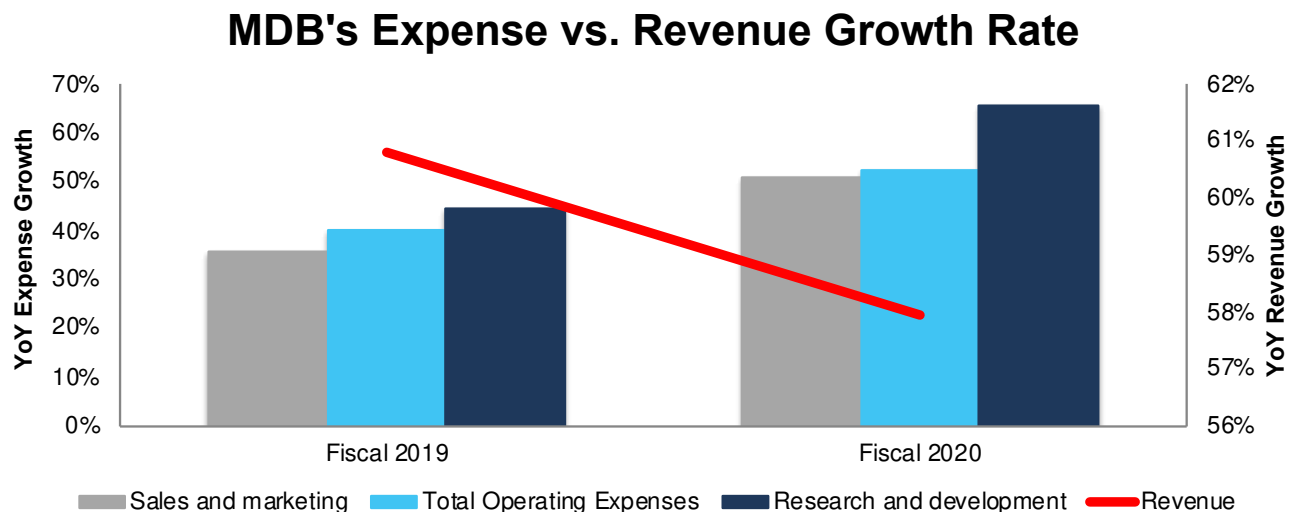
Sources: New Constructs, LLC and company filings.

#### Costs are Growing Faster While Revenue Growth Slows

As any software company grows, it aims to achieve economies of scale that allow it to turn recurring revenue streams into consistent profits. However, MongoDB's gross margins are headed in the wrong direction. The YoY growth in costs is rising while revenue growth is slowing.

In fiscal 2020, MongoDB's research and development expenses grew 66% YoY, which was up from 44% YoY in fiscal 2019. It's sales and marketing expenses grew 51% YoY (up from 36% YoY in prior year) and total operating expenses grew 53% YoY (up from 40% YoY in prior year) over the same time. Meanwhile, as noted above, YoY revenue growth rates declined.

Figure 7: MDB's Costs Are Quickly Rising as Revenue Growth Rates Fall



Sources: New Constructs, LLC and company filings.

MDB's costs of its subscription and services revenue are also rising, thereby impacting the firms overall profitability. In fiscal 2018, MongoDB's cost of revenue was 26% of revenue. Over the TTM, cost of revenue jumped to 29% of revenue. This increase has pushed MongoDB's gross margin down from 74% in fiscal 2018 to 71% TTM.



### **Costs Aren't Going Away Either**

In order to compete in the database software market, particularly against firms with longstanding relationships with potential customers, MongoDB must invest heavily in its platform and the marketing of that platform. Accordingly, investors shouldn't expect cost growth to slow down in the near future, at least not without a further slowdown in revenue.

MongoDB is highly reliant upon its direct sales force to drive meaningful revenue growth. Through April 30, 2020 customers obtained through MongoDB's direct sales force (2,200 of the firm's 18,400 total customers) accounted for 79% of subscription revenue, which was up from 77% in the prior period. In other words, 12% of the firm's customers are responsible for over three-fourths of the firm's subscription revenue. Rising reliance upon direct sales means MongoDB's sales and marketing expenses aren't going away anytime soon, thereby limiting the firm's path to profitability.

MongoDB notes in its fiscal 2020 10-K, "we expect our operating expenses to increase significantly as we increase our sales and marketing efforts, continue to invest in research and development and expand our operations and infrastructure, both domestically and internationally." Furthermore, the firm notes "we are substantially dependent on our direct sales force and our marketing efforts to obtain new customers. We plan to expand our sales and marketing organization both domestically and internationally."

If MongoDB cannot rein in costs while attracting new customers to maintain its sales growth, its plans for profitability may never materialize.

### **MDB Is Significantly Overvalued**

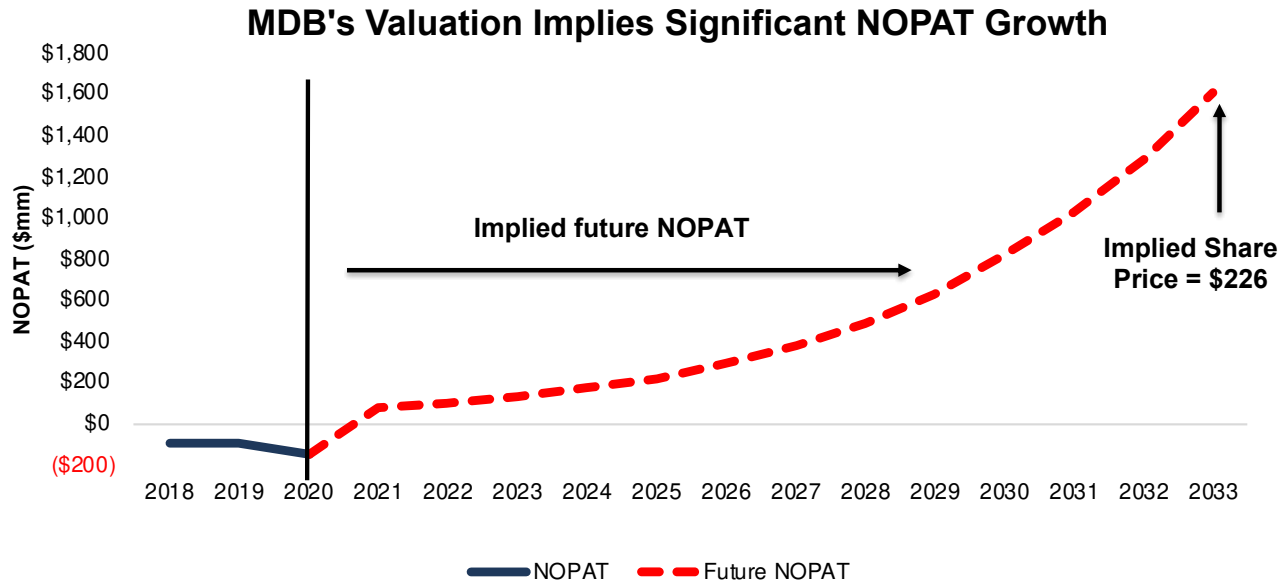
Despite volatile price movement this year, MDB has greatly outperformed the overall market since rebounding from the market crash in March. MDB is up 72% year-to-date (S&P 500 is down 5%) and trades at almost ten times its IPO price. We think the stock is more than a little overvalued. Below we'll use our [reverse DCF model](#) to quantify the future cash flow expectations baked into the current stock price.

To justify its current price of \$226/share, MDB must achieve 13% NOPAT margins, which is the average of all Software firms with a positive margin under coverage (compared to -34% TTM) and grow revenue by 30% compounded annually for the next 13 years. [See the math behind this reverse DCF scenario](#). In this scenario, MongoDB generates \$12.3 billion in revenue (13 years from now). For reference, [Allied Market Research](#) expects the entire NoSQL database market to be ~\$22 billion in 2026.

These lofty expectations seem overly optimistic given MongoDB's weak competitive position, highly negative margins, and slowing revenue growth. As noted above, the midpoint of management's fiscal 2021 guidance implies revenue grows 24% YoY, well below the revenue growth in the scenario above. Figure 8 compares the firm's implied NOPAT growth to its NOPAT decline historically.



Figure 8: MDB's Implied NOPAT Growth is Overly Optimistic



Sources: New Constructs, LLC and company filings.

Even if MongoDB can achieve a 13% NOPAT margin and grow revenue by 25% compounded annually for the next decade, the stock is worth just \$59/share today – a 74% downside. [See the math behind this reverse DCF scenario.](#)

Each of these scenarios also assumes MongoDB is able to grow revenue, NOPAT and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create best-case scenarios that demonstrate how high expectations embedded in the current valuation are. For reference, MongoDB's invested capital grew by an average of \$371 million a year (88% of fiscal 2019 revenue) in fiscal 2019 and fiscal 2020.

### Acquisition Would Be Unwise

Often the largest risk to any bear thesis is what we call “[stupid money risk](#)”, which means an acquirer comes in and pays for MongoDB at the current, or higher, share price despite the stock being overvalued. Many of the largest competitors in the industry, given their vast resources, could see an acquisition as a quick path to expanding their database software offerings. However, given the highly negative margins and overvalued stock price, we think it would be unwise for a larger firm to acquire MongoDB at current levels.

Nevertheless, we think it helps to quantify what, if any, acquisition hopes are priced into the stock.

### Walking Through the Acquisition Math

First, investors need to know that MongoDB has large liabilities that make it more expensive than the accounting numbers would initially suggest.

1. \$1.2 billion in [outstanding employee stock options](#) (9% of market cap)
2. \$33 million in [operating leases](#) (<1% of market cap)

After adjusting for these liabilities, we can model multiple purchase price scenarios. For this analysis, we chose Oracle (ORCL) as a plausible acquirer of MongoDB (which was once dubbed the “[Oracle-chaser](#)”), but analysts can use just about any company to do the same research. The key variables are the weighted average cost of capital ([WACC](#)) and ROIC for assessing different hurdle rates for a deal to create value.

Even in the most optimistic of scenarios, MongoDB is worth less than its current share price.

Figures 9 and 10 show what we think Oracle should pay for MongoDB to ensure it does not destroy shareholder value. There are limits on how much Oracle should pay for MongoDB to earn a proper return, given the NOPAT or [free cash flows](#) being acquired.



Each implied price is based on a 'goal ROIC' assuming different levels of revenue growth. In both scenarios, the estimated revenue growth rate is 24% in year one and 28% in year two, which is the midpoint of management's guidance for year one and consensus estimates for year two. For the subsequent years, we use 28% in scenario one because it represents a continuation of consensus estimates. We use 35% in scenario two because it assumes MDB could grow faster with the large support, resources, and customer base of Oracle.

We conservatively assume that Oracle can grow MongoDB's revenue and NOPAT without spending any working capital or fixed assets beyond the original purchase price. We also assume MongoDB stops its margin decline and achieves a 31% NOPAT margin, which equals Oracle's TTM NOPAT margin. For reference, MongoDB's TTM NOPAT margin was -34%.

**Figure 9: Implied Acquisition Prices for Value-Neutral Deal**

To Earn 5% ROIC On Acquisition		
Revenue Growth Scenario	MDB's Implied Stock Value	% Discount to Current Price
27% CAGR for 5 years	\$117	48%
31% CAGR for 5 years	\$144	36%

Sources: New Constructs, LLC and company filings

Figure 9 shows the 'goal ROIC' for Oracle as its WACC of 5%. This scenario represents the minimum level of performance required to not destroy value. Even if MongoDB can grow revenue by 31% compounded annually for five years, the firm is worth less than its current price of \$226/share. It's worth noting that any deal that only achieves a 5% ROIC would not be accretive, as the return on the deal would equal Oracle's WACC.

**Figure 10: Implied Acquisition Prices to Create Value**

To Earn 20% ROIC on Acquisition		
Revenue Growth Scenario	MDB's Implied Stock Value	% Discount to Current Price
27% CAGR for 5 years	(\$1)	100%
31% CAGR for 5 years	\$6	98%

Sources: New Constructs, LLC and company filings

Figure 10 shows the next 'goal ROIC' of 20%, which is Oracle's current ROIC. Acquisitions completed at these prices would be truly accretive to Oracle shareholders. Even in the best-case growth scenario, the implied stock price is significantly below MDB's current price. Without a significant increase in margins or revenue growth assumed in this scenario, such an acquisition would result in capital destruction.

**Catalyst: Missed Expectations & a Slowdown in Growth**

MongoDB has beat consensus estimates in each of the past 11 quarters. However, we've seen in the past how high-flying technology stocks can see their share prices plummet when they fail to beat expectations. With management guiding for significantly lower revenue growth rates, not solely because of the COVID-19 pandemic, investors may look elsewhere.

We think it's only a matter of time before the intense competitive pressures on MongoDB result in earnings misses. Additionally, lack of progress towards profitability could cause investors to sell the stock as the true fundamentals of the business (currently spending \$1.34 to generate \$1) reveal real profits are further off than investors believe.

As noted above, management already expects slowing revenue growth, but at the same time, they also expect larger losses. Guidance for fiscal 2021 implies 24% YoY revenue growth at the midpoint of the range, which would be down from 58% YoY in fiscal 2020. At the same time, management expects MongoDB's non-GAAP loss from operations to grow from -\$54 million in fiscal 2020 to -\$74 million (at the midpoint of guidance) in fiscal 2021.

Furthermore, management expects MongoDB's fiscal 2021 non-GAAP net loss per share to be in the range of -\$1.34 to -\$1.21/share, compared to -\$1.00/share in fiscal 2020.





As shown in Figure 2 above, non-GAAP net loss greatly understates the true losses of the firm. If even non-GAAP metrics are showing rising losses, it's clear the growth story is slipping away. We could see a reckoning for money-losing tech firms that cannot maintain the revenue growth rates that initially propelled shares to their lofty valuations. Without the high-growth tech narrative to prop up shares, investors could flee as they're forced to reconcile the firm's poor fundamentals with the lofty expectations baked into its stock price.

### What Noise Traders Miss with MongoDB

In general, markets aren't good at identifying value-destroying companies that waste shareholder capital. Instead, due to the [proliferation of noise traders](#), markets are more likely to pump up popular momentum stocks, while undervaluing high-quality, unconflicted, and comprehensive fundamental research. Here's a quick summary for what noise traders miss when analyzing MongoDB:

- Core earnings declining despite improving non-GAAP results
- Operational and capital efficiency well below the competition
- Slowing revenue growth and expensive cost structure
- Valuation implies significant improvement in margins and market share

### Executive Compensation Adds Risk

MongoDB's executives can overlook the deteriorating fundamentals of the business because their compensation is tied to metrics that don't measure fundamentals accurately. MongoDB's compensation awards annual cash bonuses upon the achievement of new annual contract value, non-new annual contract value, operating cash flow, and revenue targets. Long-term incentive compensation is provided through time-based restricted stock units. Unfortunately, each of these target goals and RSU's focus on metrics not tied to creating shareholder value.

Without significant changes to its executive compensation, executives will be incentivized to boost their growth numbers with no attention to the underlying fundamentals of the business. We'd recommend the firm's compensation committee tie pay to improving ROIC, which is [directly correlated with creating shareholder value](#).

### Insiders Are Buying but Short Interest Is High

Over the past 12 months, insiders have bought 4.1 million shares and sold 2.5 million shares for a net effect of 1.6 million shares purchases. These purchases represent 3% of shares outstanding.

There are currently 8.2 million shares sold short, which equates to 14% of shares outstanding and just under eight days to cover. Short interest is down 5% from the prior month. Clearly a portion of the market recognizes the firm's deteriorating fundamentals and overvalued stock.

### Critical Details Found in Financial Filings by Our [Robo-Analyst Technology](#)

As investors [focus more](#) on fundamental research, research automation technology is needed to analyze all the critical financial [details in financial filings](#) as shown in the Harvard Business School and MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)".

Below are specifics on the adjustments we make based on Robo-Analyst findings in MongoDB's 2020 10-K:

Income Statement: we made \$48 million of adjustments, with a net effect of removing \$31 million in [non-operating expenses](#) (7% of revenue). You can see all the adjustments made to MongoDB's income statement [here](#).

Balance Sheet: we made \$254 million of adjustments to calculate invested capital with a net decrease of \$243 million. One of the most notable adjustments was \$33 million in [operating leases](#). This adjustment represented 3% of reported net assets. You can see all the adjustments made to MongoDB's balance sheet [here](#).

Valuation: we made \$2.2 billion of adjustments with a net effect of decreasing shareholder value by \$2.2 billion. There were no adjustments that increased shareholder value. The most notable adjustment to shareholder value was \$1.2 billion in [outstanding employee stock options](#). This adjustment represents 9% of MongoDB's market cap. See all adjustments to MongoDB's valuation [here](#).



### **Unattractive Funds That Hold MongoDB**

The following funds receive our Unattractive-or-worse rating and allocate significantly to MongoDB.

1. Morgan Stanley Discovery Portfolio (MMCGX) – 4.6% allocation and Very Unattractive rating
2. Morgan Stanley Insight Fund (MCRTX) – 4.6% allocation and Very Unattractive rating
3. First Trust Cloud Computing ETF (SKYY) – 4.4% allocation and Unattractive rating
4. State Street SPDR S&P Internet ETF (XWEB) – 4.3% allocation and Unattractive rating
5. Zevenbergen Genea Fund (ZVGNX) – 3.2% allocation and Very Unattractive rating
6. Morgan Stanley Growth Portfolio (MSGUX) – 2.6% allocation and Very Unattractive rating
7. Transamerica Capital Growth (IALAX) – 2.5% allocation and Very Unattractive rating
8. Wells Fargo Specialized Technology Fund (WFSTX) – 2.4% allocation and Very Unattractive rating
9. AllianzGI Technology Fund (RAGTX) – 2.1% allocation and Very Unattractive rating

*This article originally published on [July 6, 2020](#).*

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

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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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