



## The Importance of Reading Footnotes – Filing Season 2021 Recap

During the [Real Earnings Season](#) (February 19 – March 29<sup>1</sup>), we analyzed 1,914 10-K and 10-Q filings from which our [Robo-Analyst](#)<sup>2</sup> technology collected 219,465 data points. Our analyst team made 35,498 forensic accounting [adjustments](#) with a dollar value of \$18 trillion.

**Figure 1: Filing Season 2021 – The Power of the Robo-Analyst**

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Filing Season Total	1,914	219,465	35,498	\$18,463

Sources: New Constructs, LLC and company filings.

The adjustments were applied as follows:

- 13,255 income statement adjustments with a total value of \$1.2 trillion
- 14,541 balance sheet adjustments with a total value of \$7.5 trillion
- 7,702 valuation adjustments with a total value of \$9.7 trillion

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Below, we highlight some of the items investors relying on GAAP or other measures of profitability may have missed in the latest 10-Ks and 10-Qs. Adjusting for these unusual items reveals a much different picture of a firm's profitability than reported or legacy data providers' research.

Only our research enables investors to overcome flaws with legacy fundamental datasets and apply [reliable fundamental data](#) in their research. [Core Earnings: New Data & Evidence](#), forthcoming in [The Journal of Financial Economics](#), reveals the materiality of the problems with fundamental data provided by legacy firms like Bloomberg, Refinitiv, FactSet (FDS) and S&P Global (SPGI).

### Gilead Sciences Hidden Non-Operating Items Mask Profit Growth in 2020

In its 2020 10-K, analyst Alex Sword found that Gilead Sciences recorded multiple unusual charges that were [hidden in the footnotes](#) of its annual filing. Detailed below, these hidden unusual items along with reported unusual items amount to over -\$7.4 billion in [Earnings Distortion](#) and materially distort (by -6,049%) Gilead Sciences' GAAP earnings:

Hidden Unusual Items, Net = -\$1.4 billion:

- [\\$881 million](#) in "inventory step-up adjustments" – Page 74 2020 10-K
- [\\$289 million](#) in "accelerated share-based compensation expense" – Page 74 2020 10-K
- [\\$144 million](#) in "settlement of post-acquisition unvested employee stock options" – Page 73 2020 10-K
- [\\$40 million](#) write-down for "slow moving and excess raw material and work in process inventory" – Page 59 2020 10-K
- [\\$39 million](#) in "acquisition related expenses" – Page 74 2020 10-K

Reported Unusual Items on the income statement, Net = -\$7.3 billion:

- [\\$5.9 billion](#) "acquired in process research and development expenses" – Page 56 2020 10-K

<sup>1</sup> We analyzed the majority of those filings (1,769) by March 17<sup>th</sup>.

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



- [\\$1.4 billion](#) company defined “other expense” – Page 56 2020 10-K

In addition, we made a \$1.2 billion adjustment for income tax distortion to normalize reported income taxes by removing the impact of unusual items.

After removing Earnings Distortion, which totals -\$5.89/share, we find that Gilead Sciences 2020 [Core Earnings](#) of \$5.99/share are significantly higher than GAAP net income of \$0.10/share.

**How We Treat Unusual Items:** Non-operating items, such as [restructuring](#) or [impairment](#) charges are [one of many reasons](#) why GAAP net income doesn't tell the whole story of a company's profitability.

Unlike other research firms<sup>3</sup>, we remove all [unusual gains/losses](#), including restructuring charges, to calculate Gilead Sciences' true recurring profits, i.e. [Core Earnings](#).

Without careful footnotes research, investors would never know that these non-recurring items distort GAAP numbers to the point where traditional, unscrubbed earnings for U.S. stocks are off [by an average of ~20%](#).

### Other Material Earnings Distortions & Red Flags We Found

Below are a few other highly material items that we discovered while rigorously analyzing the footnotes and MD&A during the Real Earnings Season:

Avis Budget Group, Inc. (CAR) – Unusual COVID-Related Charge

- Analyst Robbie Woodward found on [page 37](#) of Avis Budget Group's 2020 10-K an unusual COVID-19 charge that impacts GAAP net income. Avis recorded a \$10 million (1% of reported Loss before income taxes) write-down related to lost vehicles from a fire in an overflow parking lot. We remove this non-operating charge from our measure of net operating profit after tax ([NOPAT](#)) and Core Earnings. We also add-back the write-down to invested capital to hold companies accountable for all the capital invested in their businesses over their operating lives.  
After removing all Earnings Distortion, which totals -\$2.21/share (23% of GAAP net income), we find that Avis Budget Group's 2020 [Core Earnings](#) of -\$7.49/share are improved over GAAP net income of -\$9.70/share.

S&T Bancorp, Inc. (STBA) – Non-operating loss due to fraud

- Analyst Devyn DeLange noticed on page 111 of S&T Bancorp's 2020 10-K that the firm recognized a [\\$59 million](#) pre-tax loss due to fraud resulting from a [check kiting](#) scheme. We remove this non-operating charge from our measure of net operating profit after tax ([NOPAT](#)) and Core Earnings to calculate the true recurring profits of the business. After removing all Earnings Distortion (275% of GAAP EPS in 2020), S&T Bancorp's 2020 Core Earnings of \$2.01/share are greater than GAAP EPS of \$0.54.

Surgalign Holdings Inc. (SRGA) – Acquisitions and Subsequent Write-Downs

- In the third week of the Real Earnings Season, while analyzing Surgalign Holdings' 2020 10-K, analyst Alex Richmond found on [page 82](#) of Surgalign's 2020 10-K that the company acquired Holo Surgical for \$95 million and immediately determined that the technology was not feasible and recorded a write-down of \$94.5 million, [or nearly the entire purchase price](#). This charge was reported on the income statement as an asset acquisition expense. We remove this non-operating charge from our measure of net operating profit after-tax ([NOPAT](#)) and Core Earnings to calculate the true recurring profits of the business. After removing all Earnings Distortion (40% of GAAP EPS in 2020), Surgalign's 2020 Core Earnings of -\$0.64/share are lower than GAAP EPS -\$0.45.

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*Disclosure: David Trainer, Robbie Woodward, Devyn DeLange, Alex Sword, Alex Richmond, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.*

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

<sup>3</sup> [In Core Earnings: New Data & Evidence](#), professors from Harvard Business School & MIT Sloan [expose the flaws](#) in traditional, legacy fundamental data and research providers.



## ***It's Official: We Offer the Best Fundamental Data in the World***

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Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our “novel database” enables investors to overcome these flaws and apply [reliable](#) fundamental data in their research.
3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

### **Best Fundamental Data in the World**

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms’ data collection processes to provide superior [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by S&P Global’s (SPGI) *Adjustments* individually.” – pp. 14, 1<sup>st</sup> para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2<sup>nd</sup> para.

### **Superior Models**

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [ as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5<sup>th</sup> para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2<sup>nd</sup> para.

### **Superior Stock Ratings**

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are [here](#).



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