



## Write-Downs Understate True Profits & Other Findings from the Real Earnings Season

We leverage our [Robo-Analyst](#) to comb through the 10-Q's and 10-K's, including the footnotes and MD&A, of the ~3,000 companies under coverage to ensure we provide the most [reliable fundamental data](#) to our clients. Through this diligence, we found unusual items in the filings of Dropbox Inc. (DBX) and several other companies during the first week of [The Real Earnings Season](#).

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### Dropbox's Write-Downs Understate Earnings

While analyzing its 2020 10-K, analyst Garrett O'Grady found that Dropbox recorded a [\\$398 million impairment](#) (155% of 2020 GAAP net income) related to its real estate assets. In response to the COVID-19 pandemic, Dropbox implemented its "[Virtual First](#)" work policy, which made remote work the primary experience for all employees. As a result, the firm will sublease a significant amount of its current office space, and it had to take an [asset write-down](#) on the sub-leased portion of its office space where the carrying value exceeded its fair value.

**How We Treat Asset Write-Downs:** Asset write-downs, such as Dropbox's "impairment charge," are [one of many reasons](#) why GAAP net income doesn't tell the whole story of a company's profitability. We remove write-down charges to calculate a firm's true recurring profits. [Asset write-downs](#) also allow management to erase equity from the balance sheet, which can artificially improve profitability metrics like return on assets.

We add-back the after-tax value of asset write-downs to our measure of [invested capital](#). Without this diligence, investors will get a misleading picture of Dropbox's true profitability. After adjusting for all [unusual gains/losses](#), Dropbox's [Core Earnings](#) of \$116 million are much higher than GAAP net income of -\$256 million in 2020.

### Other Interesting Items We Found

Since February 19, 2021, we have parsed 681 10-Q and 10-K filings, which means Dropbox's impairment charge isn't the only unusual item our analysts have found. Below are a few other notable items we discovered while rigorously analyzing the footnotes and MD&A:

#### Consolidated Edison, Inc. (ED) – Service Interruption Liability

- While analyzing Consolidated Edison's 2020 10-K, analyst Alex Sword came across a liability for service interruption that investors may be unaware of. On [page 19](#), the firm discloses that in the event of a service interruption, it's liable for up to \$15 million in reimbursements for food and prescription medicine spoilage losses.

#### Marriott International, Inc. (MAR) – Contractual Obligation

- Analyst Cody Fincher noticed on [page 36](#) of Marriott's 2020 10-K that the firm has a contractual obligation to purchase the leasehold interest in land and a hotel for \$300 million from a hotel owner. As part of this agreement, Marriott also has an option to buy the underlying land for an additional \$200 million. After COVID-19 crushed the current value of many hotel properties, Marriott could be on the hook to purchase property at a large premium.

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

- On [page 37](#) of Avis Budget Group's 2020 10-K, analyst Robbie Woodward, found 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. As

noted above, 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.

### The Power of the Robo-Analyst

We analyzed 569 10-K and 10-Q filings last week, from which our [Robo-Analyst](#)<sup>1</sup> technology collected 68,411 data points. Our analyst team made 11,644 forensic accounting [adjustments](#) with a dollar value of \$7.8 trillion. The adjustments were applied as follows:

- 4,278 income statement adjustments with a total value of \$453 billion
- 4,739 balance sheet adjustments with a total value of \$3.1 trillion
- 2,627 valuation adjustments with a total value of \$4.3 trillion

**Figure 1: Filing Season Diligence for the Week of February 22 – February 27**

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Filing Season Week 1	569	68,411	11,644	\$7,806
Filing Season Total	681	82,662	14,161	\$9,455

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 Harvard Business School in “[Disrupting Fundamental Analysis with Robo-Analysts](#)”, our Robo-Analyst research automation technology uses machine learning and natural language processing to automate and improve financial modeling.

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

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*Disclosure: David Trainer, Garrett O’Grady, Cody Fincher, Alex Sword, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.*

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<sup>1</sup> Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).



## ***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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