



Hidden Items Make Earnings Look Much Better & Other Findings From the Real Earnings Season

Last week, our [Robo-Analyst](#) analyzed 173 filings. We're highlighting unusual items in the filings of General Electric (GE) and several other companies during the fourth week of [The Real Earnings Season](#).

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General Electric's Hidden Non-Operating Items Mask Losses in 2020

In its 2020 10-K, analyst Hunter Anderson found that General Electric 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 \$7.82 billion in [Earnings Distortion](#) and materially distort (by 150%) General Electric's GAAP earnings:

Hidden Unusual Items, Net = -\$1.62 billion:

- [\\$693 million](#) in restructuring & other – Page 41 2020 10-K
- [\\$542 million](#) in pre-tax impairments related to GE Capital Aviation Services business – Page 74 2020 10-K
- [\\$316 million](#) in a non-cash pre-tax impairment charge related to property, plant and equipment – Page 74 2020 10-K
- [\\$146 million](#) in amortization of prior service cost – Page 83 2020 10-K
- [\\$113 million](#) in non-cash pre-tax impairment charge related to amortization expense – Page 76 2020 10-K
- [\\$100 million](#) for an SEC settlement charge – Page 41 2020 10K

Reported Unusual Items, Net = \$9.57 billion:

- [\\$12.5 billion](#) in purchases and sales of business interests reported on the income statement – Page 93 2020 10-K
- \$2.6 billion adjustment for [contra earnings distortion from recurring pension costs disclosed in non-recurring items](#)
- [\\$2.4 billion](#) in non-operating benefit costs reported on the income statement – Page 56 2020 10-K
- [\\$1.7 billion](#) related to goodwill impairments reported on the income statement – Page 56 2020 10-K
- [\\$1.5 billion](#) in loss from net interest and investment bundled in "Other Income" – Page 93 2020 10-K
- [\\$334 million](#) in other items bundled in "Other Income" – Page 93 2020 10-K
- [\\$125 million](#) in loss from discontinued operations reported on the income statement – Page 56 2020 10-K

In addition, we made a -\$131 million adjustment for income tax distortion. This tax adjustment normalizes reported income taxes by removing the impact of unusual items.

After removing Earnings Distortion, which totals \$0.89/share, or 150% of GAAP EPS, we find that General Electric's 2020 [Core Earnings](#) of -\$0.30/share are significantly lower than GAAP net income of \$0.60/share.

How We Treat Non-Operating 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 firms¹, we remove all [unusual gains/losses](#), including restructuring charges, to calculate General Electric's true recurring profits, i.e. [Core Earnings](#).

¹ In [Core Earnings: New Data & Evidence](#), professors from Harvard Business School & MIT Sloan [expose the flaws](#) in traditional, legacy fundamental data and research providers.



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

Since February 19, 2021, we have parsed 1,799 10-Q and 10-K filings, and General Electric’s hidden and reported non-operating items aren’t the only unusual items our analysts have found. Below are a few other highly material Earnings Distortions that we discovered while rigorously analyzing the footnotes and MD&A:

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

- While analyzing Surgalign Holdings’ 2020 10-K, analyst Alex Richmond found on [page 82](#) 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.

American Airlines Group Inc. (AAL) – Federal Grant Disclosure

- Analyst Alex Richmond noticed that American Airlines had an interesting way of reporting their [\\$6 billion](#) grant from the federal government under the CARES act. Of the \$6 billion, American Airlines recorded [\\$1.8 billion](#) as long-term debt. [\\$3.7 billion](#) is recorded as a credit bundled in “other operating special items, net” and [\\$444 million](#) is recorded as a credit bundled in “regional operating special items, net”. “Other operating special items, net” also includes [\\$1.5 billion](#) in fleet impairment charges and [\\$1.4 billion](#) in severance charges. Bundling the government benefits with asset impairments and severance in “Special Items” allows American Airlines to manage earnings and make operations look better than they are. After removing all Earnings Distortion (6% of GAAP EPS in 2020), American Airlines 2020 Core Earnings of -\$19.47/share are less than GAAP EPS of -\$18.36.

The Power of the Robo-Analyst

We analyzed 173 10-K and 10-Q filings last week, from which our [Robo-Analyst](#)² technology collected 18,481 data points. Our analyst team made 2,986 forensic accounting [adjustments](#) with a dollar value of \$781 billion. The adjustments were applied as follows:

- 1,154 income statement adjustments with a total value of \$53 billion
- 1,233 balance sheet adjustments with a total value of \$334 billion
- 599 valuation adjustments with a total value of \$395 billion

Figure 1: Filing Season Diligence for the Week of March 15 – March 19

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Filing Season Week 4	173	18,481	2,986	\$781
Filing Season Total	1,799	207,488	33,576	\$16,524

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.

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



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

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, 1st 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, 2nd 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, 5th 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, 2nd 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, 3rd para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3rd 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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