The Most Overstated & Understated FCF in the S&P 500 Post 1Q21 Earnings

Just as our Core Earnings[1] better represent the true earnings of companies in the S&P 500 than GAAP earnings, our measure of free cash flow ("True FCF") is also better than the "Traditional FCF". Below, we feature the firms[2] and sectors (excluding Financials[3]) with the most overstated and understated FCF in the S&P 500.

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S&P 500 Constituents With the Most Under/Overstated FCF

Overall, Traditional FCF for the S&P 500 understates True FCF by more than $105 billion, or 22% of Traditional FCF, over the trailing-twelve-months (TTM) for non-financial firms.

Figure 1 shows the S&P 500 companies with the most understated and overstated FCF (in total dollars) over the TTM. We detail the differences between True and Traditional FCF for Pfizer (PFE) and AbbVie (ABBV) below.

Figure 1: S&P 500 Companies with Most Under/Overstated Free Cash Flow: TTM

Ticker	Name	True FCF	Traditional FCF	Difference
Most Understated FCF ($ in billions)				
F	Ford Motor Company	($3.6)	($49.8)	($46.1)
PFE	Pfizer Inc.	$33.7	($1.7)	($35.4)
DD	Dupont De Nemours Inc.	$24.7	($4.6)	($29.3)
PPL	PPL Corporation	$17.1	($6.9)	($24)
MPC	Marathon Petroleum Corp	$11.4	($10.4)	($21.8)
Most Overstated FCF ($ in billions)				
ABBV	AbbVie, Inc.	($68.2)	$30.6	$98.8
TMUS	T-Mobile US Inc	($103.8)	($8.4)	$95.4
GM	General Motors Co	($10.1)	$54.7	$64.9
MSFT	Microsoft Corporation	$29.7	$56.2	$26.5
GILD	Gilead Sciences, Inc.	($22.6)	$2.6	$25.1

Sources: New Constructs, LLC and company filings.

Formula for True FCF Is Simple, But Finding Necessary Data is Hard

Here are the formulas we use for Traditional FCF and True FCF.

Traditional FCF:

EBIT[4] - Taxes - Change in Working Capital + Depreciation and Amortization - CAPEX - Acquisitions

True FCF:

Net Operating Profit After Tax (NOPAT) - Change in Invested Capital

Or

NOPAT - Change in Adjusted Working Capital - Change in Adjusted Fixed Assets[5]

[1] Only Core Earnings enable investors to overcome the flaws in legacy fundamental data and research, as proven in Core Earnings: New Data & Evidence, a paper in The Journal of Financial Economics written by professors at Harvard Business School (HBS) & MIT Sloan.
[2] Due to a lack of a sufficient number of available filings to calculate a Traditional FCF over the TTM, we exclude Amcor Plc (AMCR) from this analysis.
[3] We exclude 76 Financials sector companies and non-Financials companies with significant financial operating subsidiaries.
[4] EBIT is net of stock-based compensation.
[5] Change in Adjusted Fixed Assets includes acquisitions.

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The recipient of this report is directed to read these disclosures.

Traditional FCF Is Materially Different From True FCF

Unlike Traditional FCF, our calculation of free cash flow is more comprehensive and accounts for:

- hidden non-operating income,
- changes in reserves,
- excess cash,
- asset write-downs,
- accumulated other comprehensive income (OCI),
- off-balance sheet debt, and
- numerous other adjustments

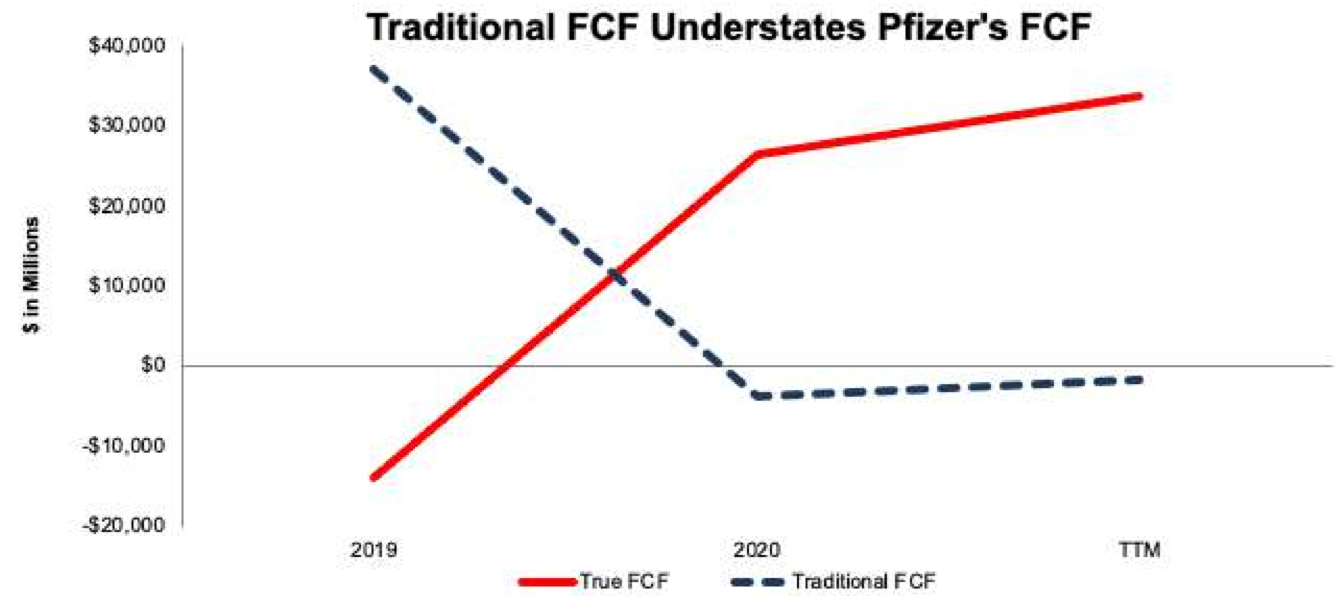
We make each of these adjustments to the income statement and balance sheet when calculating True FCF. Just as with our Core Earnings data and research, our FCF calculation leverages more reliable fundamental data[6] that enables investors to overcome flaws with legacy fundamental datasets.

While the calculation for True FCF looks simple, finding all the hidden and reported items required to eliminate accounting loopholes, often buried in footnotes & MD&A of financial filings, is much more difficult.

Pfizer's True FCF Is Understated by $35 Billion

Pfizer's True FCF accounts for 51% of the Healthcare sector True FCF and is understated by more than $35 billion, or 2,025% of Traditional FCF. Figure 2 shows Pfizer's True FCF and Traditional FCF moving in opposite directions since 2019.

Figure 2: Pfizer: True FCF Vs. Traditional FCF: 2019-TTM



Sources: New Constructs, LLC and company filings.

The differences between True FCF and Traditional FCF are driven by the differences between:

1. NOPAT and EBIT
2. Change in net working capital vs. change in adjusted net working capital, and
3. the change in adjusted fixed assets vs. depreciation and amortization - CAPEX - acquisitions.

The following is a summary of these differences when calculating Pfizer's TTM FCF:

- The difference between NOPAT and EBIT is $288 million:
    - $156 million in non-operating expense hidden in operating earnings, consisting of
        - $238 million in implementation costs – 2020 10-K Page 70

[6] For 3rd-party reviews, including The Journal of Financial Economics, on our more reliable fundamental data, historically and prospectively, across all stocks, click here and here.

        - -$40 million in sublease income – 2020 10-K Page 97
        - $10 million in cost of sales – 1Q21 10-Q Page 14
        - -$3 million in additional depreciation – asset restructuring – 2020 10-K Page 70
    - $63 million in asset write-downs hidden in operating earnings
        - $46 million in asset write-offs and impairments – 1Q21 10-Q Page 9
        - $23 million in additional depreciation – asset restructuring – 2020 10-K Page 70
    - $62 million in interest for the present value of operating leases
- The difference between change in net working capital and adjusted net working capital is $15.1 billion.
- The difference between change in adjusted fixed assets vs. depreciation and amortization - CAPEX - acquisitions is $21.2 billion.

Figure 3 reconciles Pfizer's True FCF and Traditional FCF and details each of the differences listed above.

Figure 3: Pfizer: True FCF Vs. Traditional FCF Detailed Comparison

True FCF (TTM) Item	$ (mm)	Traditional FCF (TTM) Item	$ (mm)	Difference ($mm)
Reported EBIT	$10,956	Reported EBIT	$10,956	
+ Net Non-Operating Expense Hidden in Operating Earnings	$156			
+ Asset Write-Downs Hidden in Operating Earnings	$63			
+ Amortization of Prior Service Cost in Non-Operating Items	$43			
+ Interest for PV of Operating Leases	$62			
= NOPBT	$11,281			
- Cash Operating Taxes	$1,280	- Cash Operating Taxes[7]	$1,243	
= NOPAT	**$10,001**	**= EBIT After Tax**	**$9,713**	**($288)**
Change in Required Cash	*($124)*	*Change in Cash and Equivalents*	*$3,317*	
Change in Accounts Receivable/Inventory/Other	*$1,480*	*Change in Accounts Receivable/Inventory/Other*	*$1,480*	
Change in Current Assets	$1,356	Change in Current Assets	$4,797	
Change in NIBCL	*$4,417*	*Change in NIBCL*	*$4,417*	
Change in Hidden Short-Term Operating Lease Liabilities	*($34)*	*Change in Short-Term Debt*	*($11,655)*	
Change in Current Liabilities	$4,383	Change in Current Liabilities	($7,238)	
= Change in Adjusted Working Capital	**($3,027)**	**= Change in Working Capital**	**$12,035**	**$15,062**
Change in Adjusted Fixed Assets	($13,314)	Depreciation & Amortization	$3,423	
Change in Asset Write-Downs After Tax	$1,830	CAPEX	($2,850)	
Change in Accumulated OCI	($9,127)			
Change in Off-Balance-Sheet Operating Leases	$67			
Change in Hidden Fixed Operating Lease Assets	($60)			
Change in Hidden Deferred Tax Assets	($30)			
= Change in Adjusted Fixed Assets	**($20,634)**	**= Depreciation & Amortization - CAPEX - Acquisitions**	**$573**	**$21,207**
True FCF	**$33,662**	**Traditional FCF**	**($1,749)**	**($35,411)**

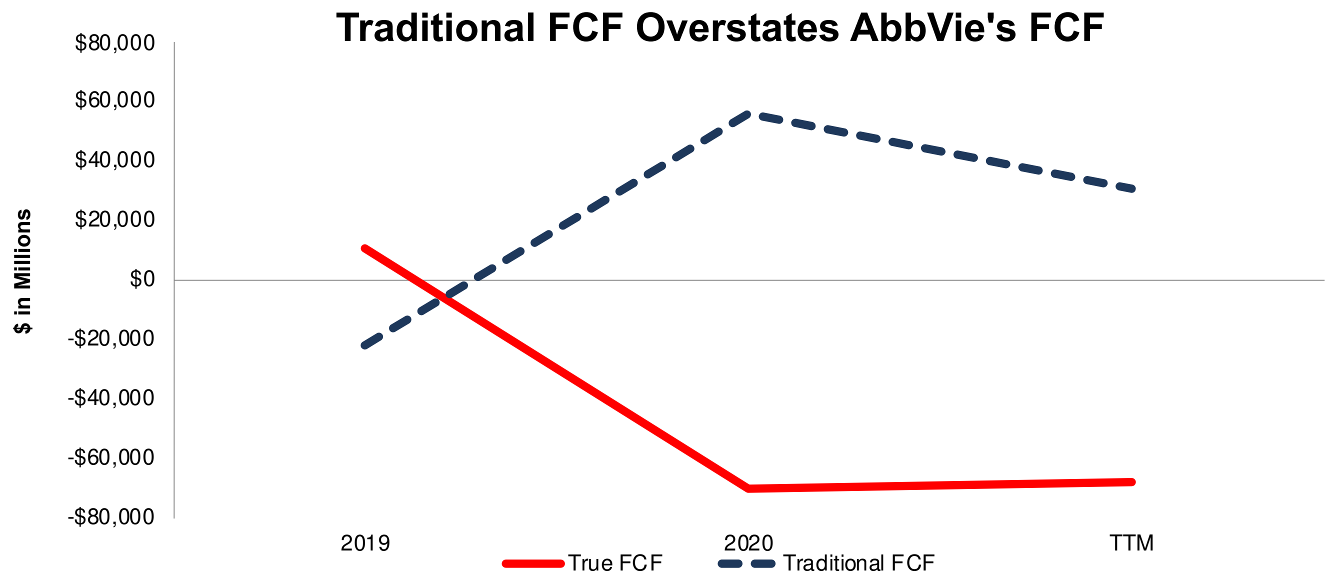
Sources: New Constructs, LLC and company filings.

[7] We calculate the Cash Operating Taxes applied to Reported EBIT and NOPBT using the same cash operating tax rate.

AbbVie's FCF Is Most Overstated in the S&P 500

AbbVie's FCF is overstated by more than $98 billion, or 328% of Traditional FCF, over the TTM, the most of all non-financial S&P 500 firms over the TTM. Since 2019, AbbVie's True FCF fell from $11.1 billion to -$68.2 billion TTM, while Traditional FCF rose from -$21.9 billion to $30.6 billion TTM.

Figure 4: AbbVie: True FCF Vs. Traditional FCF: 2019-TTM



Sources: New Constructs, LLC and company filings.

The following is a summary of the differences between the two calculations of AbbVie's TTM FCF:

- The difference between NOPAT and EBIT is $1.6 billion:
    - $1.6 billion net non-operating expense hidden in operating earnings
        - $781 million in acquisition-related expenses – 2020 10-K Page 62
        - $696 million in severance and employee benefits – 2020 10-K Page 66
        - $435 million in other integration – 2020 10-K Page 66
        - $60 million in restructuring charges recorded – 2020 10-K Page 67
    - $42 million in interest for present value of operating leases
    - -$3 million in amortization of prior service cost
        - -$2 million in amortization of prior service – 2020 10-K Page 80
        - -$1 million in amortization of prior service – 1Q21 10-Q Page 17
- The difference between change in net working capital and adjusted net working capital is $39.2 billion.
- The difference between change in adjusted fixed assets vs depreciation and amortization - CAPEX - acquisitions is $106.4 billion.

Figure 5 reconciles AbbVie's True FCF and Traditional FCF and details each of the differences listed above.

Figure 5: AbbVie: True FCF Vs. Traditional FCF Detailed Comparison

True FCF (TTM) Item	$ (mm)	Traditional FCF (TTM) Item	$ (mm)	Difference ($mm)
Reported EBIT	$13,131	Reported EBIT	$13,131	
+ Net Non-Operating Expense Hidden in Operating Earnings	$1,618			
+ Amortization of Prior Service Cost in Non-Operating Items	($3)			
+ Interest for PV of Operating Leases	$42			
= NOPBT	$14,788			
- Cash Operating Taxes	$640	- Cash Operating Taxes[8]	$568	
= NOPAT	**$14,418**	**= EBIT After Tax**	**$12,563**	**($1,586)**
Change in Required Cash	*$323*	*Change in Cash and Equivalents*	*($31,365)*	
Change in Accounts Receivable/Inventory/Other	*$6,176*	*Change in Accounts Receivable/Inventory/Other*	*$6,176*	
Change in Current Assets	$6,499	Change in Current Assets	($25,189)	
Change in NIBCL	*$7,895*	*Change in NIBCL*	*$7,895*	
Change in Hidden Short-Term Operating Lease Liabilities	*($50)*	*Change in Short-Term Debt*	*$7,585*	
Change in Current Liabilities	$7,846	Change in Current Liabilities	$15,480	
= Change in Adjusted Working Capital	**($1,347)**	**= Change in Working Capital**	**($40,669)**	**($39,222)**
Change in Adjusted Fixed Assets	$84,264	Depreciation & Amortization	$8,127	
Change in Asset Write-Downs After Tax	$1,238	CAPEX	($861)	
Change in Accumulated OCI	($402)	Acquisitions	($29,906)	
Change in Off-Balance-Sheet Operating Leases	$435			
Change in Hidden Fixed Operating Lease Assets	($413)			
Change in Hidden Deferred Tax Assets	($1,424)			
= Change in Adjusted Fixed Assets	**$83,698**	**= Depreciation & Amortization - CAPEX - Acquisitions**	**($22,640)**	**($106,338)**
True FCF	**($68,202)**	**Traditional FCF**	**$30,592**	**$98,794**

Sources: New Constructs, LLC and company filings.

Ranking the Sectors by Difference in True vs Traditional FCF

Figure 6 ranks 10 of the 11 S&P 500 sectors (excluding Financials) by the dollar value difference between Traditional and True FCF. The Telecom Services sector has the most overstated Traditional FCF (in total dollars), while the Industrials sector has the most understated Traditional FCF. T-Mobile U.S. (TMUS), with FCF overstated by more than $95 billion, is a large contributor to the ~$72 billion difference between Traditional and True FCF in the Telecom Services sector. Southwest Airlines (LUV), Delta Air Lines (DAL), and United Airlines Holdings (UAL) account for a combined $38 billion of the ~$87 billion in understated FCF in the Industrials sector.

[8] We calculate the Cash Operating Taxes applied to Reported EBIT and NOPBT using the same cash operating tax rate.

Figure 6: TTM True FCF Vs. Traditional FCF by S&P 500 Sector (Excluding Financials)

Sector	True FCF ($mm)	Traditional FCF ($mm)	Over(under)stated ($mm)
Telecom Services	($86,641)	($14,598)	$72,043
Healthcare	$66,032	$113,482	$47,450
Energy	$19,494	$23,761	$4,267
Utilities	($19,573)	($22,163)	($2,590)
Real Estate	$31,176	$25,706	($5,470)
Technology	$308,704	$292,149	($16,555)
Consumer Non-cyclicals	$79,406	$50,220	($29,186)
Consumer Cyclicals	$31,551	$41	($31,510)
Basic Materials	$66,421	$10,484	($55,937)
Industrials	$86,861	($524)	($87,385)
S&P 500	**$583,431**	**$478,558**	**($104,873)**

Sources: New Constructs, LLC and company filings.

Get Quarterly Updates on the S&P 500 and Its Sectors

Every quarter, we provide the latest look at FCF and FCF yield for the S&P 500 and each of its sectors. Get the most recent update in S&P 500 & Sectors: Free Cash Flow Yield Through 1Q21.

In addition to FCF, we provide fundamental market and sector trends analysis in S&P 500 & Sectors: Core Earnings Vs. GAAP Net Income Through 1Q21, S&P 500 & Sectors: ROIC vs. WACC Through 1Q21, and S&P 500 & Sectors: Price-to-Economic Book Value Through 1Q21. Additionally, we provide similar analysis of our all cap index, the NC 2000, which can be found here.

This article originally published on June 9, 2021.

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

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Appendix: Calculation Methodology

We derive the metrics above by summing the Trailing Twelve Month individual S&P 500 constituent values for Free Cash Flow in each sector and for the entire S&P 500. We call this approach the “Aggregate” methodology.

The Aggregate methodology provides a straightforward look at the entire sector and index, regardless of market cap or index weighting and matches how S&P Global (SPGI) calculates metrics for the S&P 500.

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.

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