



Core Earnings Improved in All NC 2000 Sector’s Through 3Q21

Corporate profits, when properly measured, have been much less volatile than implied by GAAP earnings since the first quarter of 2020.

This report is an abridged and free version of [All Cap Index & Sectors: Core Earnings Vs. GAAP Earnings Through 3Q21](#), one of our quarterly series on [fundamental market and sector trends](#). The full version of the report analyzes [Core Earnings](#)¹² and GAAP earnings of the NC 2000³, our All Cap Index, and each of its sectors. Last quarter’s analysis is [here](#). These reports are available to clients with a [Pro or higher](#) membership or can be purchased [here](#).

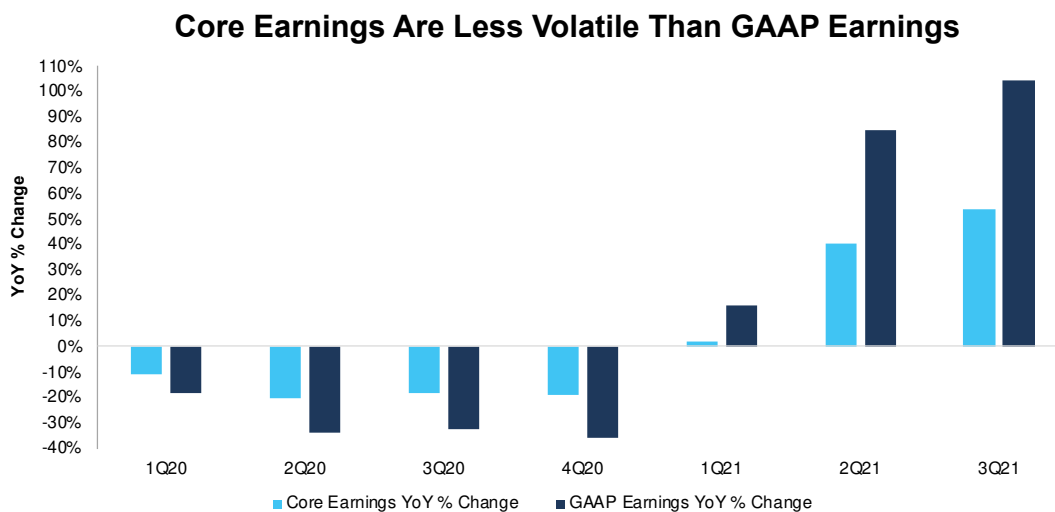
Accounting Distortions Across the NC 2000

Figure 1 shows Core Earnings, which adjust for [unusual gains/losses](#), are less volatile than GAAP earnings in the NC 2000. For instance:

- In 2021, GAAP earnings rose 105% through 3Q21 compared to a 50% rise for Core Earnings.
- In 2020, GAAP earnings fell 36% YoY compared to a 19% fall for Core Earnings.

At the end of 2020, Core Earnings of \$1.2 trillion were 34% higher than GAAP earnings of \$896 billion. Now, at \$1.80 trillion, Core Earnings are 2% less than GAAP earnings of \$1.84 trillion.

Figure 1: NC 2000 Core Earnings Vs. GAAP YoY Percent Change: 1Q20 – 3Q21



Sources: New Constructs, LLC and company filings.

Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

The November 16, 2021 measurement period incorporates the financial data from 3Q21 10-Qs, as this is the earliest date for which all the 3Q21 10-Qs for the NC 2000 constituents were available.

Our research leverages [more reliable fundamental data](#)⁴ that overcomes [flaws with legacy fundamental datasets](#) to provide a more informed view of the fundamentals of companies and a [new source of alpha](#).

Learn more about the best fundamental research

¹ Core Earnings enable investors to overcome the flaws in legacy fundamental data and research, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan for [The Journal of Financial Economics](#).

² Based on the latest audited financial data, which is the 10-Q for calendar 3Q21 in most cases.

³ The NC 2000 consists of the largest 2000 U.S. companies by market cap in our coverage. Constituents are updated on a quarterly basis (March 31, June 30, September 30, and December 31). We exclude companies that report under IFRS and non-U.S. ADR companies.

⁴ Three independent studies prove the superiority of our data, models, and ratings. Learn more [here](#).



2021 GAAP Earnings Widely Overstated

For 832 companies in the NC 2000, forty-two percent, GAAP Earnings overstate Core Earnings for the trailing-twelve-months (TTM) ended calendar 3Q21. Shockingly, when GAAP Earnings overstate Core Earnings, they do so by an average of 208%, per Figure 2. The overstatement was more than ten percent of GAAP Earnings for twenty-three percent of companies.

The 832 companies with overstated GAAP earnings make up 55% of the market cap of the NC 2000.

Figure 2: NC 2000 GAAP Earnings Overstated⁴ by 188% On Average

Overstated GAAP Earnings	Overstated by >10%	Average Overstated %
832 companies	455 companies	208%

Sources: New Constructs, LLC and company filings.
We use Funds from Operations (FFO) for Real Estate companies rather than GAAP Earnings.

Key Details on Select NC 2000 Sectors

Core Earnings rose on a year-over-year (YoY) basis for all eleven sectors of the NC 2000 in 3Q21, up from ten sectors in the second quarter. The Energy sector saw the largest YoY percentage improvement in Core Earnings, which rose from \$7.9 billion in 3Q20 to \$42.2 billion in 3Q21.

The Technology sector generates the most Core Earnings, at \$454.1 billion, and grew Core Earnings by 48% YoY in 3Q21. On the flip side, the Real Estate sector has the lowest Core Earnings at \$31.0 billion, and the Consumer Non-cyclicals sector had the weakest YoY growth in 3Q21.

Below we highlight the Technology sector and a stock with some of the most Earnings Distortion (i.e. overstated GAAP earnings) in the sector.

Sample Sector Analysis⁵: Technology

Figure 3 shows Core Earnings for the Technology sector, at \$454.1 billion, rose 48% YoY in 3Q21, while GAAP earnings, at \$492.0 billion, rose 58%. Our analysis of the NC 2000 and [S&P 500 Technology sector](#) illustrates disparity in profitability between the largest Technology firms and the rest of the sector.

For example, the 77 stocks in the S&P 500 Technology sector generated \$443.2 billion in TTM Core Earnings in 3Q21, while the 310 stocks in the NC 2000 Technology sector generated \$454.1 billion in TTM Core Earnings in 3Q21. In fact, the five most profitable Technology firms in the NC 2000, Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL), Facebook (FB), and Intel (INTC), generate \$274.9 billion in Core Earnings as of 3Q21, which represents 61% of the entire NC 2000 Technology sector’s Core Earnings.

⁴ Overstated companies include all companies with Earnings Distortion >0.1% of GAAP earnings.

⁵ The full version of this report provides analysis for all eleven sectors.



Figure 3: Technology Core Earnings Vs. GAAP: 1998 – 3Q21



Sources: New Constructs, LLC and company filings.

Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

The November 16, 2021 measurement period incorporates the financial data from 3Q21 10-Qs, as this is the earliest date for which all the 3Q21 10-Qs for the NC 2000 constituents were available.

GAAP Earnings Overstatement Details: DXC Technology Company (DXC)

Below, we detail the [hidden and reported](#) unusual items that aren't captured in GAAP Earnings but are captured in Core Earnings for DXC Technology Company (DXC), a stock with some of the most Earnings Distortion, and, therefore, overstated GAAP Earnings, in the Technology sector.

After adjusting for unusual items, we find that DXC's Core Earnings of \$0.07/share over the trailing-twelve-months (TTM) are 96% less than reported GAAP Earnings of \$1.53/share. DXC Technology's [Earnings Distortion Score](#) is Strong Miss. Our [stock rating](#) for DXC is Very Unattractive and is flagged with the "Weak Internal Control" [analyst note](#) due to the auditor's opinion that DXC failed to maintain effective internal control over financial reporting in its fiscal 2021 10-K.

Figure 4 details the differences between Core Earnings and GAAP Earnings so readers can audit our research.

Figure 4: DXC Technology's GAAP Earnings to Core Earnings Reconciliation

	TTM (\$ per share)
GAAP Net Income	\$1.53
– Reported Unusual Gains Pre-Tax, Net	\$6.40
– Hidden Unusual Expenses, Net	(\$1.18)
– Tax Distortion	(\$3.76)
= Core Earnings	\$0.07

Sources: New Constructs, LLC and company filings.



More details from DXC Technology's trailing twelve months of financials⁶:

Reported Unusual Gains Pre-Tax, Net = \$6.40/per share, which equals \$1.6 billion and is comprised of:

- \$2.4 billion in gains on disposition of businesses in the TTM period based on
 - [\\$377 million](#) gain in 1Q22
 - [-\\$42 million](#) loss in 4Q21
 - [\\$2.0 billion](#) gain in 3Q21
- \$36 million other income in the TTM period based on
 - [\\$102 million](#) in income in 2Q22
 - [\\$103 million](#) in income in 1Q22
 - [-\\$296 million](#) in expense in 4Q21
 - [\\$127 million](#) in income in 3Q21
- -\$14 million in foreign currency losses in the TTM period based on
 - [-\\$14 million](#) loss in 4Q21
- -\$110 million in non-service cost components of net periodic pension expense in the TTM based on
 - [-\\$110 million](#) in 4Q21
- -\$117 million contra adjustment for [recurring pension costs](#). These recurring expenses are reported in non-recurring line items, so we add them back and exclude them from Earnings Distortion.
- -\$350 million in debt extinguishment costs in the TTM period based on
 - [-\\$281 million](#) in 2Q22
 - [-\\$28 million](#) in 1Q22
 - [-\\$41 million](#) in 4Q21
- -\$426 million in restructuring costs in the TTM period based on
 - [-\\$145 million](#) in 2Q22
 - [-\\$67 million](#) in 1Q22
 - [-\\$110 million](#) in 4Q21
 - [-\\$104 million](#) in 3Q21

Hidden Unusual Expenses, Net = -\$1.18/per share, which equals -\$301 million and is comprised of:

- -\$186 million in impairment losses in the TTM period based on
 - [-\\$10 million](#) in 2Q22
 - [-\\$176 million](#) across 4Q21 and 3Q21
- -\$159 million in transaction, separation, and integration costs in the TTM period based on
 - [-\\$3 million](#) in 2Q22
 - [-\\$9 million](#) in 1Q22
 - [-\\$51 million](#) in 4Q21
 - [-\\$96 million](#) in 3Q21
- \$44 million in sublease income in the TTM period based on
 - [\\$17 million](#) in 2Q22
 - [\\$9 million](#) in 1Q22
 - [\\$8 million](#) in 4Q21
 - [\\$10 million](#) in 3Q21

Tax Distortion = -\$3.76/per share, which equals -\$960 million

- We remove the tax impact of unusual items on reported taxes when we calculate Core Earnings. It is important that taxes get adjusted so they are appropriate for adjusted pre-tax earnings.

This article originally published on [December 3, 2021](#).

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

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

⁶ Quarters referenced correspond to DXC Technology's fiscal quarters.



Appendix: Calculation Methodology

We derive the Core Earnings and GAAP Earnings metrics above by summing the trailing-twelve-month individual NC 2000 constituent values for Core Earnings and GAAP Earnings in each sector for each measurement period. We call this approach the “Aggregate” methodology.

The Aggregate methodology provides a straightforward look at the entire sector, 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.

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](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.