



Street Earnings Understated for 30% of S&P 500 Companies in 1Q22

While Street Earnings (based on [Zacks Earnings](#)) overstate profits for the majority of S&P 500 companies, as shown in [Street Earnings Overstated for 67% of S&P 500 Companies in 1Q22](#), there are also many S&P 500 companies whose Street Earnings understate their true profits. These companies are more profitable than investors realize and, in most cases, undervalued as well.

This report shows:

- the prevalence and magnitude of understated Street Earnings in the S&P 500
- why Street Earnings (and GAAP earnings) are flawed
- five S&P 500 companies with understated Street Earnings and Very Attractive [Stock Ratings](#)

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Over 150 S&P 500 Companies Have Understated Street Earnings

For 152 companies in the S&P 500, Street Earnings understate [Core Earnings](#)^{1,2} for the trailing-twelve-months (TTM) ended calendar 1Q22. In the TTMs ended 1Q21 and 2021, 131 and 155 companies understated their earnings, respectively.

When Street Earnings understate Core Earnings, they do so by an average of -27% per company, per Figure 1. Street Earnings understate Core Earnings by >10% for ~9% of S&P 500 companies

Figure 1: Street Earnings Understated by -28% on Average in TTM Through 1Q22

Understated Street Earnings	Understated by >10%	Average Understated % ³
152 companies	44 companies	-27%

Sources: New Constructs, LLC and company filings.

The 152 companies with understated Street Earnings represent 27% of the market cap of the S&P 500 as of 5/16/22, which is up from 20% through 2021, measured with TTM data in each quarter.

The increase from the prior TTM period is driven largely by Microsoft (MSFT) and NVIDIA Corporation's (NVDA) Street Earnings falling from overstated through 2021 to understated through 1Q22. Combined, these two firms make up 7% of the S&P 500 market cap through 5/16/22.

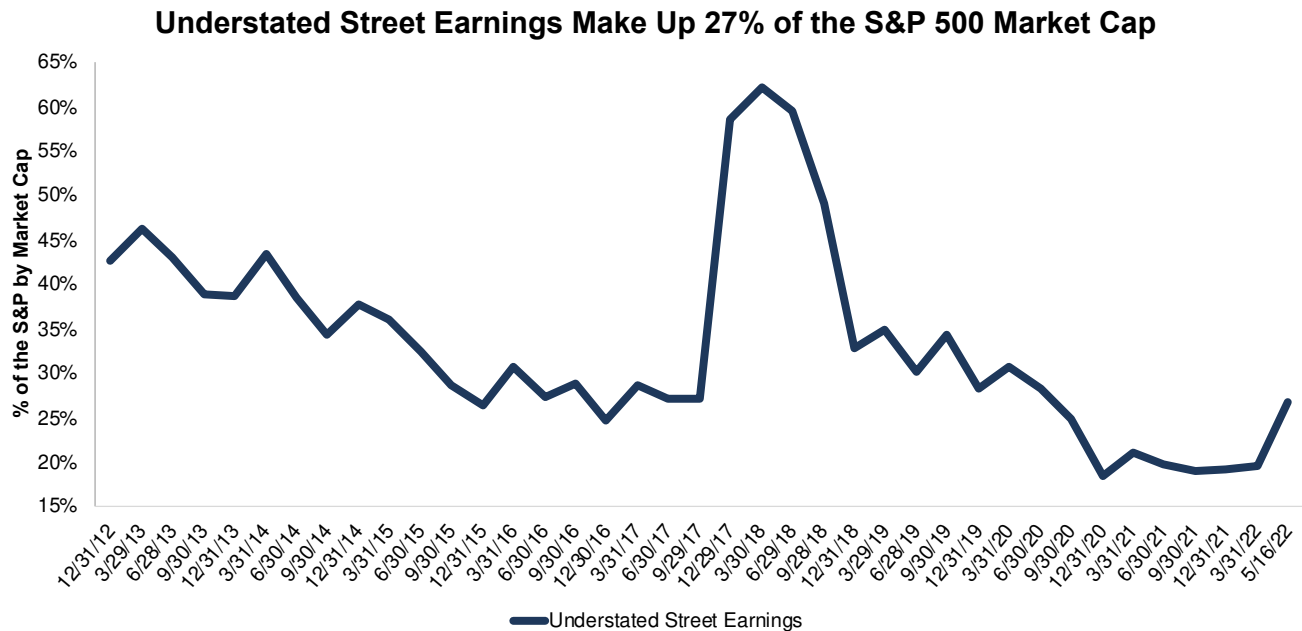
¹ [The Journal of Financial Economics](#) features the superiority of our Core Earnings in [Core Earnings: New Data & Evidence](#).

² Our Core Earnings research is based on the latest audited financial data, which is the calendar 1Q22 10-Q in most cases. Price data as of 5/16/22.

³ Average understated % is calculated as Street Distortion, which is the difference between Street Earnings and Core Earnings.



Figure 2: Understated Street Earnings as % of Market Cap: 2012 through 5/16/22



Sources: New Constructs, LLC and company filings.

The Five Most Understated Earnings in the S&P 500

Companies that understate earnings are rarer than in years past but you can find them - if you know where to look.

Figure 3 shows five S&P 500 stocks with Very Attractive [Stock Ratings](#) and the most understated Street Earnings (based on Street Distortion as a % of Street Earnings per share) over the TTM through 1Q22. “Street Distortion” equals the difference between Core Earnings per share and Street Earnings per share. Investors using Street Earnings miss the true profitability of these businesses.

Figure 3: S&P 500 Companies with Most Understated Street Earnings: TTM Through 1Q22

Ticker	Name	Street EPS	Core EPS	Understated %*	Stock Rating
NRG	NRG Energy, Inc.	\$7.08	\$17.37	-145%	Very Attractive
ZION	Zions Bancorporation	\$6.14	\$9.64	-57%	Very Attractive
FANG	Diamondback Energy Inc.	\$14.17	\$20.23	-43%	Very Attractive
CB	Chubb Limited	\$13.89	\$18.64	-34%	Very Attractive
WRB	W.R. Berkley Corp	\$3.78	\$4.63	-22%	Very Attractive

Sources: New Constructs, LLC and company filings.
 *Measured as Street Distortion as a percent of Street EPS

In the section below, we detail the [hidden and reported](#) unusual items that distort GAAP Earnings for Diamondback Energy (FANG). All these unusual items are removed from Core Earnings.

Diamondback Energy’s (FANG) TTM 1Q22 Street Earnings Understated by \$6.06/share

The difference between Diamondback Energy’s TTM 1Q22 Street Earnings (\$14.17/share) and Core Earnings (\$20.23/share) is \$6.06/share, per Figure 4. We call that difference “Street Distortion,” which equals 43% of Street Earnings.

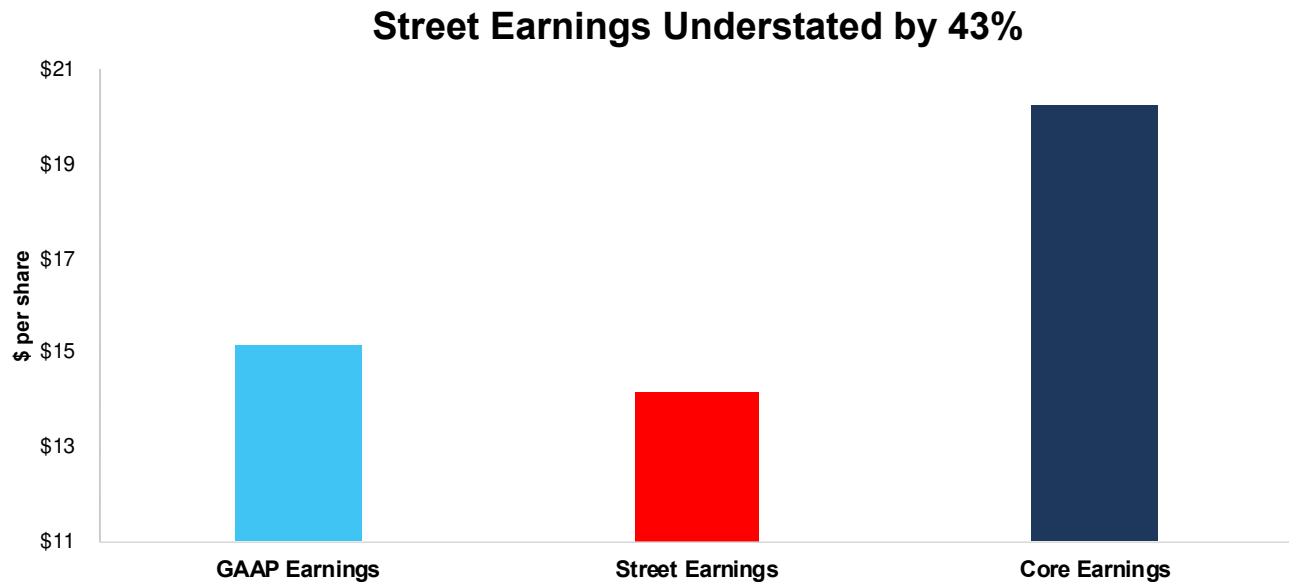
Diamondback Energy’s TTM 1Q22 GAAP Earnings (\$15.16/share) understate Core Earnings by \$5.07/share.

In a somewhat unusual situation, Diamondback Energy’s Street Earnings are even more distorted by unusual items than GAAP Earnings.



This example shows how Street Earnings suffer from many of the same shortcomings as GAAP measures of earnings. Our proprietary process for gathering and adjusting financial filings overcomes these shortcomings.

Figure 4: Comparing Diamondback Energy’s GAAP, Street, and Core Earnings: TTM Through 1Q22



Sources: New Constructs, LLC and company filings.

Below, we detail the differences between Core Earnings and GAAP Earnings so readers can audit our research. We would be happy to reconcile our Core Earnings with Street Earnings but cannot because we do not have the details on how analysts calculate their Street Earnings.

Diamondback Energy’s [Earnings Distortion Score](#) is Strong Beat and its Stock Rating is Very Attractive, in part due to its top-quintile return on invested capital ([ROIC](#)) and price-to-economic book value ([PEBV](#)) ratio of 0.5. Diamondback Energy has an economic book value ([EBV](#)), or no growth value, of \$264/share – an 86% upside from the current price.

Figure 5 details the differences between Diamondback Energy’s Core Earnings and GAAP Earnings.

Figure 5: Diamondback Energy’s GAAP Earnings to Core Earnings Reconciliation: TTM Through 1Q22

	TTM 1Q22 (\$ per share)
GAAP Net Income	\$15.16
– Reported Unusual Expenses Pre-Tax, Net	(\$7.20)
– Hidden Unusual Expenses, Net	(\$0.05)
– Tax Distortion	\$2.19
= Core Earnings	\$20.23

Sources: New Constructs, LLC and company filings.

More details:

Total Earnings Distortion of -\$5.07/share, which equals -\$916 million, is comprised of the following:

Reported Unusual Expenses Pre-Tax, Net = -\$7.20/per share, which equals -\$1.3 billion and is comprised of

- -\$1.2 billion loss on derivative instruments in the TTM period based on
 - [-\\$552 million](#) loss in 1Q22
 - [\\$47 million](#) gain in 4Q21
 - [-\\$234 million](#) loss in 3Q21
 - [-\\$497 million](#) loss in 2Q21
- -\$79 million loss in reported other financing expenses in the TTM period based on



- [-\\$54 million](#) loss on extinguishment of debt in 1Q22
- [-\\$2 million](#) loss on extinguishment of debt in 4Q21
- [-\\$11 million](#) in other fees and expenses in 4Q21
- [-\\$12 million](#) loss on extinguishment of debt in 3Q21
- -\$10 million in other expense in the TTM period based on
 - [\\$1 million](#) income in 1Q22
 - [-\\$6 million](#) expense in 4Q21
 - [\\$2 million](#) income in 3Q21
 - [-\\$7 million](#) expense in 2Q21
- -\$3 million merger and integration expense in the TTM period based on
 - [-\\$1 million](#) in 4Q21
 - [-\\$2 million](#) in 2Q21
- Reversal of a -\$3 million impairment of midstream assets that was disclosed in a [prior 10-Q](#) but no longer disclosed in the 2021 10-K
- [\\$23 million](#) gain on sale of equity method investments in 2Q21

Hidden Unusual Expenses, Net = -\$0.05/per share, which equals -\$9.8 million and is comprised of

- [-\\$10 million](#) in the TTM period based on -\$13 million in revisions in estimated liabilities in the 2021 10-K
 - Page F-25 (page 100 overall)

[Tax Distortion](#) = \$2.19/per share, which equals \$396 million

The similarities between Street Earnings and GAAP Earnings for Diamondback indicates that Street Earnings miss many of the unusual items in GAAP Earnings, and the \$6.06/share Street Distortion highlights that Core Earnings include a more comprehensive set of unusual items when calculating Diamondback Energy's true profitability.

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

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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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