



Updating our Free Cash Flow Yield Calculation and Stock Ratings & Adding “All Cash” and “No Cash” Metrics to Models

We are updating the [Free Cash Flow Yield](#) calculation used in our [Stock Ratings](#) and [ETF & Mutual Fund Ratings](#) to use a new calculation that:

1. removes the impact of changes in cash balances from the calculation of Free Cash Flow and
2. uses a 2-year average Free Cash Flow value.

Before this update, Free Cash Flow Yield in our Stock and Fund Ratings was calculated as:

$$\text{Free Cash Flow} / \text{Enterprise Value.}$$

After this update, the FCF Yield calculation that we use in our ratings will be:

$$\text{2-Year Average Free Cash Flow (excluding cash)} / \text{Enterprise Value.}$$

This update to our Free Cash Flow Yield calculation improves the metric in two key ways:

1. **Removes the impact of cash from the calculation of Free Cash Flow:** The original version of Free Cash Flow = NOPAT - Change in Invested Capital. This update eliminates the impact of all cash line items (e.g. new cash raised from selling shares, acquiring new debt, or changes to our [required cash assumption](#)) on Free Cash Flow. The goal for this update is to focus more on the underlying economics of the business.
2. **Uses a 2-year average for Free Cash Flow:** A 2-year average limits the year-to-year volatility of Free Cash Flow and provides a more normalized assessment of the business. A single-year Free Cash Flow is more easily distorted by one-time events such as large asset purchases or other large outlays.

We expect this update to impact Overall Stock Ratings as follows:

- Improve one level for 88 companies
- Worse by one level for 91 companies
- Worse by two levels 1 companies.

These Overall Stock Rating changes are driven by changes in our underlying Free Cash Flow Yield rating (one of the five metrics that make up our Overall Stock Rating). FCF Yield ratings are expected to change as follows:

- Better for 553 companies
- Worse for 753 companies.

In addition to the updates to our ratings, we are also adding “all cash” and “no cash” versions of several metrics in our [Company Model](#). The “all cash” versions will include all of a company’s cash, not just the required cash in the calculation of the metrics. The “no cash” versions will remove all cash from the calculations. [Institutional members](#) will find “all cash” and “no cash” versions of the metrics below in our Company Models on the ROIC, Free Cash Flow, and Economic Earnings pages:

- NOPAT
- Invested Capital
- ROIC
- Free Cash Flow
- Economic Earnings

Providing the two new versions of these metrics allows investors to analyze the economics of companies through multiple lenses. No two companies are the same, and no single metric perfectly captures the economics of every company. That’s why we provide multiple versions of metrics using our [proven-superior fundamental data](#).

We expect these changes will be live on our site on July 18, 2024.



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Disclosure: David Trainer, Kyle Guske II, Hakan Salt, and Robbie Woodward receive no compensation to write about any specific stock, sector, style, or theme.

Questions on this report or others? Join our [online community](#) and connect with us directly.



It's Official: We Deliver 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. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

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

Ernst & Young 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 Harvard Business School. 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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