New Constructs®
Diligence | Independence | Performance

DILIGENCE PAYS 9/11/24

Improving our Company Model for Homebuilders – Updates to Interest and Debt Treatment

Through regular review of our models, we identified an opportunity to improve how we treat interest and debt in our models for all homebuilders.

Generally, we treat the amortization of capitalized interest as a financing activity and consider it to be a non-operating expense. However, as homebuilders often use debt to acquire land upon which to build their finished product, many homebuilders bundle the amortization of capitalized interest in cost of sales. After reviewing disclosures in 10-Qs and 10-Ks, we're updating our models to more closely align with how homebuilders use debt in their operations.

The changes being made through this update are:

1. Treat capitalized interest as an operating expense and include in total interest expense
2. Treat all debt as operating debt instead of financing debt

After these changes, our models will better represent the ongoing operations of homebuilders and how they use debt.

This update will generally result in the following changes for homebuilders:

1. lower NOPAT: capitalized interest expense will now be considered an operating expense.
2. lower interest coverage ratio: interest expense will rise due to the inclusion of capitalized interest.
3. lower Invested Capital: debt will now be treated as operating, which will increase current liabilities and lower net working capital.

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

- Improve for three companies
- Decline for three companies

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

- Improve for one company
- Decline for six companies

No two companies are the same, and no single metric perfectly captures the economics of every company. That's why we're always looking to improve our models based on the latest disclosures and continue providing clients proven-superior fundamental data.

These changes are live on our site as of September 10, 2024.

This article was originally published on September 11, 2024.

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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