Asset Write-Downs Reveal Risk

Raising Red Flags on Value Destruction

Trust

We deliver the whole truth by incorporating critical data from the Financial Footnotes and MD&A that other firms miss.

Performance

The value and success of our ratings are unrivaled. Click here for proof.

More Reports

Click here and enter a ticker to buy more of our reports.

- **Beware of companies with artificially high profits based on asset write-downs. Their stocks could collapse.**
- **Write-downs reveal management incompetence. They result from asset values falling below book values.**
- **Only 53 of the current S&P 500 companies have no write-downs. The other S&P 500 companies wrote down more than $920 billion. Buy our premium report for the complete list of S&P 500 companies with no write-downs and the 150 top offenders.**
- **137 companies have written down more than $1 for each dollar on their balance sheets. Buy our premium report for the complete list of companies.**

-------- Secrets to Finding Write-Downs --------

- **Asset write-downs are hard to find and require expertise in Financial Footnotes to identify. They go by a wide variety of code names as shown on Page 2.**
- **Appendix A shows how we unearth write-downs buried in the Financial Footnotes.**
- **Asset write-downs cause accounting earnings to be an unreliable measure of corporate profitability.**
- **We reverse all accounting distortions, including over 43,000 asset-write downs, to reveal the true economic profitability of over 3,000 companies.**

Figure 1: Value Destroyers in the S&P 500 – Sample of 5 Companies

Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	Return on Invested Capital (ROIC)	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
AKAM	Akamai Technologies, Inc.	96%	4.7%	13.5%	-8.9%
EXPE	Expedia Inc.	52%	6.3%	11.4%	-5.1%
JDSU	JDS Uniphase Corp	3523%	-0.1%	-2.2%	2.1%
SYMC	Symantec Corporation	69%	5.9%	14.8%	-8.8%
VRSN	VeriSign Inc.	619%	1.3%	6.2%	-5.0%

Sources: New Constructs, LLC. and company filings

Secrets About Asset Write-Downs

Asset write-downs are hard to find. Companies use a wide variety of code names when reporting them, and companies often only report them in the Financial Footnotes. Based on our analysis of over 50,000 filings, we have identified an alarmingly large variety of terms that identify asset write-downs. Below are some samples:

1. Impairment of goodwill or other intangible assets
2. Write-off of PP&E or other long-lived assets
3. Buy the premium report for the remaining list of terms.
4. --
5. --
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8. --
9. --
10. --

Companies are required to write down an asset if its book value permanently exceeds its fair value. Book value equals the amount paid for the asset, less any accumulated depreciation. Fair value usually equals the amount of future cash flows, discounted to their present value, the asset is expected to generate. Given that management is paid to create value, not destroy it, an asset write-down represents management's failure to allocate capital effectively.

We reverse ALL accounting distortions to reveal *accurate* and *comparable* economic earnings for 3,000+ companies.

See our chapter in the *Valuation Handbook* (Wiley Finance, 2009) for more information.

Companies are required to write down unproductive assets because accounting rules are for debt investors, not equity investors. Debt investors are concerned with ensuring that a company's assets can cover its debts—worthless assets are therefore written down; equity investors are concerned with how efficient the business is at generating profits on each dollar invested.

Reported earnings let managers off the hook for poor capital allocation—economic earnings do not.

Since companies usually receive a deferred tax benefit from an asset write-down, we account for the after-tax portion of the asset write-down in our analysis. Note that pre-tax value of write-downs is much larger, and could be considered a more accurate reflection of management's failures given that the tax benefit of write-downs is more of an IRS gift than a function of management skill.

We account for all asset write-downs in all 10-K filings since 1998. Write-downs of investment assets for financial companies are reflected in net operating profit after-tax (NOPAT) in the period in which they occur and are not accumulated in invested capital.

Special Focus: Asset Write-Downs in the S&P 500

We can analyze the frequency and size of write-downs for any group of companies.

In the following we provide unrivaled insight into write-downs by the current S&P 500 companies, which have written off more than $920 billion (after-tax) in assets since 1998 (3.8% of assets). Figure 1 above lists a sample of value destroyers in the S&P 500. Buy our premium report for a list of the 150 top offenders and the list of the 53 companies with no asset write-downs.

A disturbing number of S&P 500 companies have written down more than $1 for each dollar on their balance sheets. In other words, management of these companies has, over time, caused the value of assets it has acquired to decrease so much that the cumulative value destroyed exceeds the value of all their assets currently. Managers are paid to create, not destroy value. It is hard to believe that the managers responsible for such an abysmal capital allocation track record will create enough shareholder to reward investors.

Investors must account for *all* capital invested in the operations of the business—including capital invested in unsuccessful investments—to determine a company's true economic performance. Investors who ignore critical information in the Financial Footnotes on asset write-downs paint an incomplete and inaccurate picture of corporate performance.

For example, Figure 1 shows that Akamai Technologies' return on invested capital (ROIC) falls from a second-quintile, value-creating 13.5% to a bottom-quintile, value-destroying 4.7%[1]. Rigorous backtesting shows that using a comprehensive ROIC that includes write-downs outperforms traditional ROIC metrics that look only at the balance sheet.

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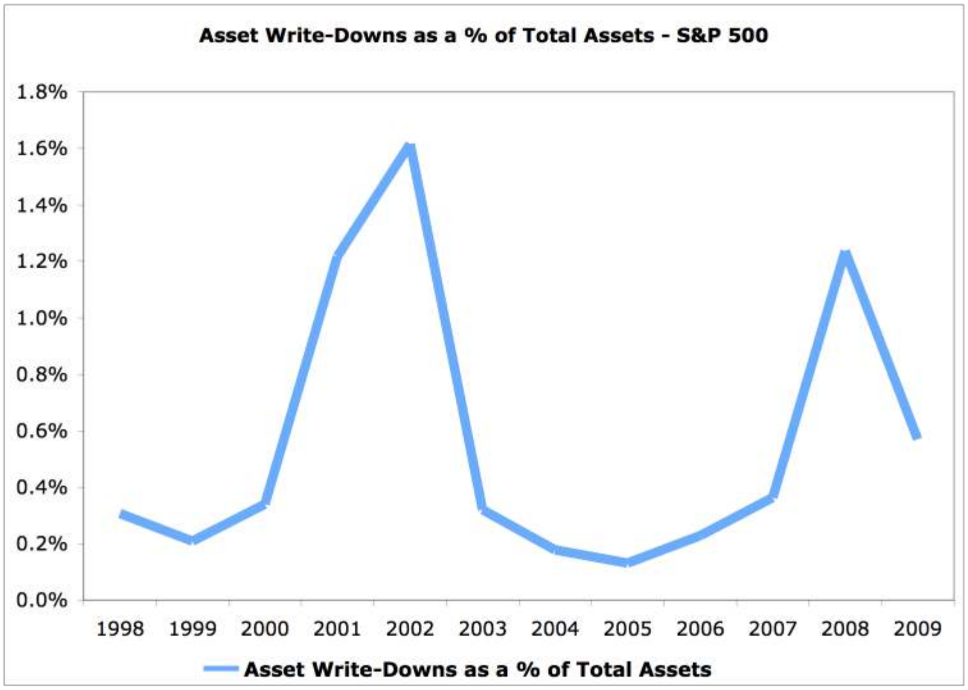
[1] Since AKAM's weighted-average cost of capital (WACC) is greater than its ROIC (9.1% WACC versus 4.7% ROIC), the company is destroying value.

Figure 2 shows annual asset write-downs for S&P 500 companies since 1998.

Figure 2: Asset Write-Downs Over Time – S&P 500



Sources: New Constructs, LLC. and company filings

Notice the large spike in asset write-downs in 2001-2002 and 2007-2008. These spikes correspond to the bursting of the recent global asset bubbles. During asset bubbles, companies over-invest in low-return and value-destroying projects. As seen in Figure 2, once the bubbles burst, companies write-down these unproductive and worthless assets.

See our blog post on how artificially low interest rates contribute to over-investment in low-return and value-destroying activities.

More Red Flag Reports

In addition to our recently released Red Flag Reports on off-balance-sheet operating leases and the alternative fuel mixture credit windfall, be on the lookout for more Red Flag Reports from New Constructs. Future reports will focus on the following accounting distortions:

- **Over/Under-Funded Pensions**
- **Reserves**
- **Non-Operating Expenses Hidden in Operating Expenses**
- **Employee Stock Options**
- **Discontinued Operations**
- **Accumulated Other Comprehensive Income**
- **Excess Cash**
- **Unconsolidated Subsidiaries**

See our Corporate Disclosure Transgressions report for a more examples of Red Flags.

All our 3000+ models include vital data scoured from the Financial Footnotes. Better Data gives you Smarter Analysis.

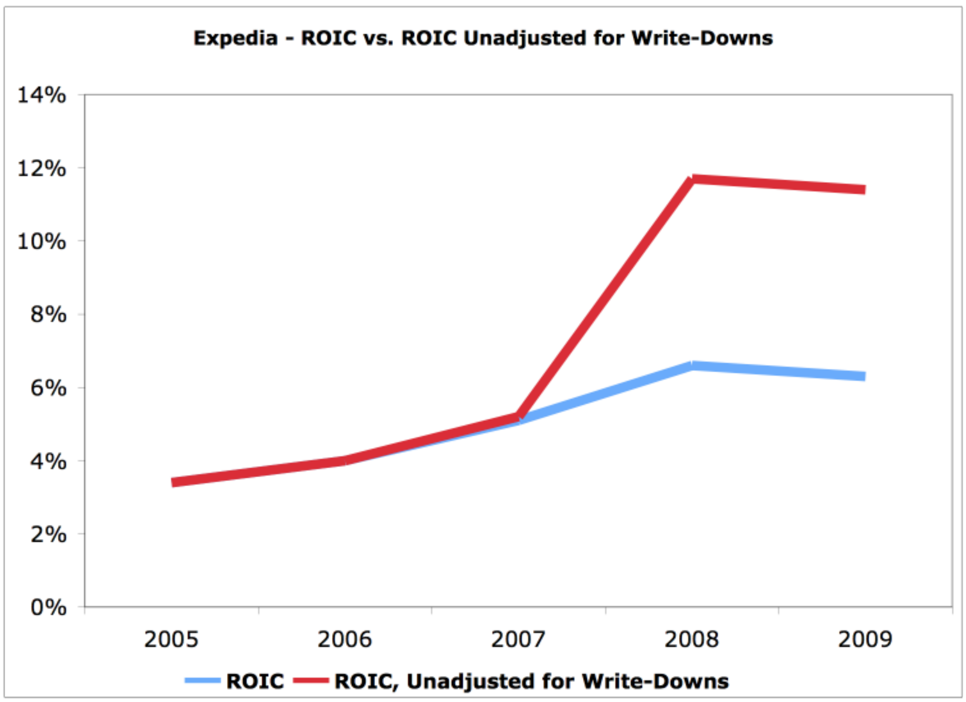
Appendix A – Case Study – Expedia, Inc.

Expedia (EXPE) has written down over $3 billion, more than $0.52 for every dollar in assets currently on its books. Without this information, investors may fall under the false impression that EXPE is more profitable that it truly is. A false impression of EXPE's profitability and the skill of its management could lead to major write-downs in an investor's portfolio if the stock collapses once investors realize the company's true profitability. EXPE's 2009 ROIC drops from 11% to 6% (nearly cut in half) when all write-downs are included in invested capital.

Impact of Write-Downs on EXPE's Historical Performance

Figure 3 shows the impact of the accumulated write-downs on EXPE's return on invested capital (ROIC):

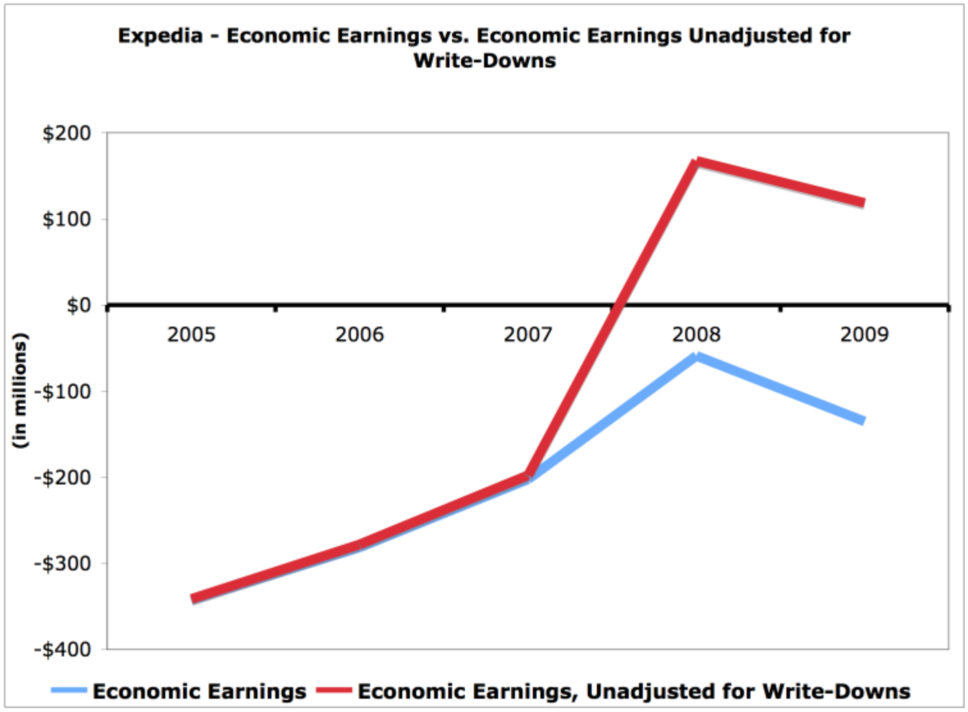
Figure 3: Impact of Accumulated Write-Downs on ROIC



Sources: New Constructs, LLC. and company filings

In 2008, EXPE wrote down over a third of its balance sheet (see Figure 7 below for a major portion of the 2008 write-down). This write-down allows EXPE to report an artificially low capital base that will deceivingly boost all future returns on capital. Investors must account for all capital invested in the operations of the business—including capital invested in unsuccessful investments—to determine a company's true economic performance. EXPE's 2009 ROIC drops from 11% to 6% when all write-downs are included in invested capital. See Figure 4 for the impact of the accumulated write-downs on EXPE's economic earnings.

Figure 4: EXPE – Economic Earnings vs. Unadjusted Economic Earnings



Sources: New Constructs, LLC. and company filings

Figure 4 compares economic earnings to unadjusted economic earnings. Notice that unadjusted economic earnings are positive in 2009 while economic earnings adjusted for write-downs are negative. Our analysis of write-downs shows that EXPE has never created value for shareholders. Investors who ignore write-downs from the Financial Footnotes are being misled even when using sophisticated metrics like economic earnings.

Write-Down Examples – EXPE

Our patented system can see through poor and confusing disclosure in the Financial Footnotes to reveal the economic truth of companies.

Figure 5: $23.4 Million Write-off of Long-Term Investment:

NOTE 7 — Long-Term Investment and Other Assets

Write-off of Long-Term Investment

In 2005, we received information regarding the deteriorating financial condition of our long-term investment in a leisure travel company and we determined that it was not likely we would recover any of our investment because the decline in its value was determined to be other-than-temporary. As a result, we recorded a loss related to this impairment of $23.4 million, which consisted of $22.5 million of preferred stock and $0.9 million of stock warrants.

F-20

Source: EXPE 2005 10-K, Note 7, Page F-20

Figure 6: $47.0 Million Impairment of Intangible Asset

Our indefinite lived intangible assets relate principally to trade names and trademarks acquired in various acquisitions. Based on lower than expected year-to-date revenue growth, we determined that our indefinite lived trade name intangible asset related to Hotwire might be impaired during the third quarter of 2006. Accordingly, we performed a valuation of that asset and determined that its carrying amount exceeded its fair

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Expedia, Inc.

Notes to Consolidated Financial Statements — (Continued)

value and recognized an impairment charge of $47.0 million in "Impairment of intangible asset" in our consolidated statements of income. We based our measurement of fair value of the trade name intangible asset using the relief-from-royalty method. This method assumes that a trade name has value to the extent that its owner is relieved of the obligation to pay royalties for the benefits received therefrom.

Source: EXPE 2006 10-K, Note 5, Page F-18 to F-19

Figure 7: $2,762 Million Goodwill Impairment Charge

Expedia, Inc.

Notes to Consolidated Financial Statements — (Continued)

The following table presents the changes in goodwill by reportable segment:

	North America	Europe	Other(1)	Total
		(In thousands)		
Balance as of January 1, 2007	$ 4,740,698	$1,021,351	$ 99,243	$ 5,861,292
Additions	140,428	—	201	140,629
Deductions	(9,402)	—	—	(9,402)
Foreign exchange translation	—	7,778	6,041	13,819
Balance as of December 31, 2007	$ 4,871,724	$1,029,129	$105,485	$ 6,006,338
Additions	134,267	181,777	12,405	328,449
Impairment charge	(1,982,000)	(758,900)	(21,200)	(2,762,100)
Other deductions	(2,823)	—	—	(2,823)
Foreign exchange translation	(3,765)	(22,126)	(5,404)	(31,295)
Balance as of December 31, 2008	$ 3,017,403	$ 429,880	$ 91,286	$ 3,538,569

(1) Other includes Asia Pacific and Egencia.

Source: EXPE 2008 10-K, Note 5, Page F21

"[Accounting] Earnings, earnings per share and earnings growth are misleading measures of corporate performance." (from page 66 in The Quest For Value by Bennett Stewart, Harper Collins 1991).

We find the true economic profitability for 3000+ stocks.

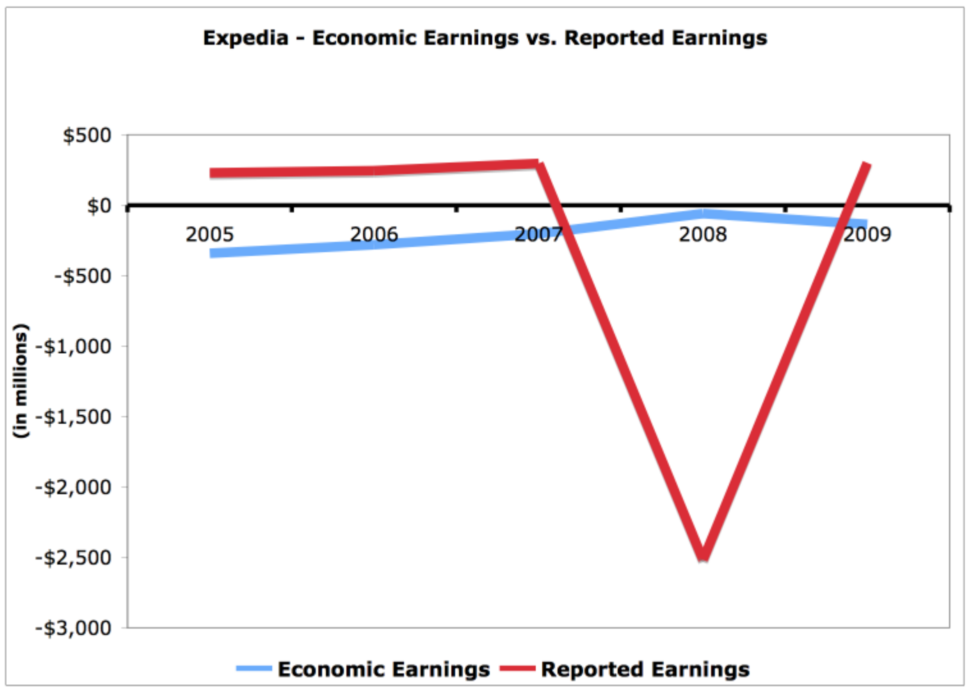
Reported Earnings vs. Economic Earnings

We uncover the true economic earnings of companies by incorporating critical data found only in the Financial Footnotes that other firms miss. Write-downs are only one piece of the puzzle. We make over 15 major adjustments to convert reported earnings to economic earnings.

Figure 8 compares EXPE's economic earnings, which account for all major adjustments, to reported earnings. Notice that EXPE's 2009 economic earnings are negative and falling while reported earnings are positive and rising.

Click here for a free report on EXPE.

Figure 8: EXPE – Economic Earnings vs. Reported Earnings



Sources: New Constructs, LLC. and company filings

Appendix B – Asset Write-Downs in S&P 500 Companies – 150 Top Offenders

Buy our premium report for a list of the top 150 asset write-down offenders in the S&P 500. For a detailed rating of any S&P 500 or Russell 3000 company, purchase a Company Valuation Report. Sample reports are available in the Free Archive on our website.

Rank	Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	ROIC	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
1	JDSU	JDS Uniphase Corp	3523%	-0.1%	-2.2%	2.1%
2	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
8	-	-	-	-	-	-
9	-	-	-	-	-	-
10	-	-	-	-	-	-
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	-	-	-
14	-	-	-	-	-	-
15	-	-	-	-	-	-
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37	-	-	-	-	-	-
38	-	-	-	-	-	-
39	-	-	-	-	-	-
40	-	-	-	-	-	-
41	-	-	-	-	-	-
42	-	-	-	-	-	-
43	-	-	-	-	-	-
44	-	-	-	-	-	-
45	-	-	-	-	-	-
46	-	-	-	-	-	-
47	-	-	-	-	-	-
48	-	-	-	-	-	-
49	-	-	-	-	-	-
50	-	-	-	-	-	-

Rank	Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	ROIC	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
51	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only
52	-	-	-	-	-	-
53	-	-	-	-	-	-
54	-	-	-	-	-	-
55	-	-	-	-	-	-
56	-	-	-	-	-	-
57	-	-	-	-	-	-
58	-	-	-	-	-	-
59	-	-	-	-	-	-
60	-	-	-	-	-	-
61	-	-	-	-	-	-
62	-	-	-	-	-	-
63	-	-	-	-	-	-
64	-	-	-	-	-	-
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99	-	-	-	-	-	-
100	-	-	-	-	-	-

Rank	Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	ROIC	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
101	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only
102	-	-	-	-	-	-
103	-	-	-	-	-	-
104	-	-	-	-	-	-
105	-	-	-	-	-	-
106	-	-	-	-	-	-
107	-	-	-	-	-	-
108	-	-	-	-	-	-
109	-	-	-	-	-	-
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145	-	-	-	-	-	-
146	-	-	-	-	-	-
147	-	-	-	-	-	-
148	-	-	-	-	-	-
149	-	-	-	-	-	-
150	-	-	-	-	-	-

Appendix C – S&P 500 Companies with No Write-Downs

Buy our premium report for a list of the 53 companies in the S&P 500 with no asset write-downs. For a detailed rating of any S&P 500 or Russell 3000 company, purchase a Company Valuation Report. Sample reports are available in the Free Archive on our website.

Ticker	Company Name	ROIC
Premium Report Only	Premium Report Only	Premium Report Only
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Appendix D – Asset Write-Downs in all Companies – Worst Offenders

Buy our premium report for a list of all companies with asset write-downs greater than reported total assets. For a detailed rating of any Russell 3000 company, purchase a Company Valuation Report. Sample reports are available in the Free Archive on our website.

Rank	Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	ROIC	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
1	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only
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3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	-	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	-
8	-	-	-	-	-	-
9	-	-	-	-	-	-
10	-	-	-	-	-	-
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	-	-	-
14	-	-	-	-	-	-
15	-	-	-	-	-	-
16	-	-	-	-	-	-
17	-	-	-	-	-	-
18	-	-	-	-	-	-
19	-	-	-	-	-	-
20	-	-	-	-	-	-
21	-	-	-	-	-	-
22	-	-	-	-	-	-
23	-	-	-	-	-	-
24	-	-	-	-	-	-
25	-	-	-	-	-	-
26	-	-	-	-	-	-
27	-	-	-	-	-	-
28	-	-	-	-	-	-
29	-	-	-	-	-	-
30	-	-	-	-	-	-
31	-	-	-	-	-	-
32	-	-	-	-	-	-
33	-	-	-	-	-	-
34	-	-	-	-	-	-
35	-	-	-	-	-	-
36	-	-	-	-	-	-
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38	-	-	-	-	-	-
39	-	-	-	-	-	-
40	-	-	-	-	-	-
41	-	-	-	-	-	-
42	-	-	-	-	-	-
43	-	-	-	-	-	-
44	-	-	-	-	-	-
45	-	-	-	-	-	-
46	-	-	-	-	-	-
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48	-	-	-	-	-	-
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54	-	-	-	-	-	-
55	-	-	-	-	-	-
56	-	-	-	-	-	-
57	-	-	-	-	-	-
58	-	-	-	-	-	-
59	-	-	-	-	-	-
60	-	-	-	-	-	-
61	-	-	-	-	-	-
62	-	-	-	-	-	-
63	-	-	-	-	-	-
64	-	-	-	-	-	-
65	-	-	-	-	-	-
66	-	-	-	-	-	-
67	-	-	-	-	-	-
68	-	-	-	-	-	-
69	-	-	-	-	-	-
70	-	-	-	-	-	-
71	-	-	-	-	-	-
72	-	-	-	-	-	-
73	-	-	-	-	-	-
74	-	-	-	-	-	-
75	-	-	-	-	-	-
76	-	-	-	-	-	-
77	-	-	-	-	-	-
78	-	-	-	-	-	-
79	-	-	-	-	-	-
80	-	-	-	-	-	-
81	-	-	-	-	-	-
82	-	-	-	-	-	-
83	-	-	-	-	-	-
84	-	-	-	-	-	-
85	-	-	-	-	-	-
86	-	-	-	-	-	-
87	-	-	-	-	-	-
88	-	-	-	-	-	-
89	-	-	-	-	-	-
90	-	-	-	-	-	-
91	-	-	-	-	-	-
92	-	-	-	-	-	-
93	-	-	-	-	-	-
94	-	-	-	-	-	-
95	-	-	-	-	-	-
96	-	-	-	-	-	-
97	-	-	-	-	-	-
98	-	-	-	-	-	-
99	-	-	-	-	-	-
100	-	-	-	-	-	-

Rank	Ticker	Company Name	Accumulated Write-Downs as a % of Total Assets	ROIC	ROIC, Unadjusted for Write-Downs	Impact of Write-Downs on ROIC
101	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only	Premium Report Only
102	-	-	-	-	-	-
103	-	-	-	-	-	-
104	-	-	-	-	-	-
105	-	-	-	-	-	-
106	-	-	-	-	-	-
107	-	-	-	-	-	-
108	-	-	-	-	-	-
109	-	-	-	-	-	-
110	-	-	-	-	-	-
111	-	-	-	-	-	-
112	-	-	-	-	-	-
113	-	-	-	-	-	-
114	-	-	-	-	-	-
115	-	-	-	-	-	-
116	-	-	-	-	-	-
117	-	-	-	-	-	-
118	-	-	-	-	-	-
119	-	-	-	-	-	-
120	-	-	-	-	-	-
121	-	-	-	-	-	-
122	-	-	-	-	-	-
123	-	-	-	-	-	-
124	-	-	-	-	-	-
125	-	-	-	-	-	-
126	-	-	-	-	-	-
127	-	-	-	-	-	-
128	-	-	-	-	-	-
129	-	-	-	-	-	-
130	-	-	-	-	-	-
131	-	-	-	-	-	-
132	-	-	-	-	-	-
133	-	-	-	-	-	-
134	-	-	-	-	-	-
135	-	-	-	-	-	-
136	-	-	-	-	-	-
137	-	-	-	-	-	-

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2. Standard for all companies.
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