Operating Lease Update

We have recently updated our treatment of Operating Lease Obligations to use a fixed rate as the discount rate for capitalizing the lease obligations and calculating the implied interest for all companies over all history.

The Present Value of Operating Lease Obligations represents the future obligations for which companies are liable according to their lease contracts. Currently, Operating Leases are not capitalized on the balance sheet and are excluded from other interest-beating liabilities. We add this value to Invested Capital as a representation of the off-balance sheet liability imbedded in a leasing contract. In addition, we add the value of Implied Interest from Operating Leases to Net Operating Profit After-tax.

Previously, we used an individual company's Cost of Debt to discount the future obligations and calculate implied interest. This presented two main problems: companies with higher debt costs benefited from lower capitalized operating leases and changing debt spreads impacted NOPAT.

In order to provide consistency and transparency in our models, we have chosen to use a historically fixed rate we refer to as the Cost of Operating Lease Obligations. This rate is based on an average value for Cost of Debt across our coverage base. In the future, the fixed rate will change only when the cost of debt changes significantly. Ratings changes caused by a change in the Cost of Operating Lease Obligations will be flagged, and notices will be sent to all clients affected.

The following is a full list of the 24 ratings changes caused by the new Cost of Operating Lease Obligations:

Operating Lease Obligation Rating Changes

Ticker	New Rating	Old Rating
ANF	Dangerous	Neutral
AVP	Attractive	Very Attractive
BBBY	Very Attractive	Attractive
BURL	Dangerous	Neutral
CKEC	Dangerous	Neutral
DIN	Neutral	Attractive
DKS	Neutral	Attractive
DVCR	Dangerous	Neutral
FET	Dangerous	Neutral
FINL	Neutral	Attractive
FVE	Dangerous	Neutral
GCO	Dangerous	Neutral
GES	Dangerous	Neutral
JCOM	Dangerous	Neutral
JWN	Very Attractive	Attractive
MFRM	Dangerous	Neutral
NGVC	Dangerous	Neutral
ODP	Neutral	Attractive
RCII	Dangerous	Neutral
RRD	Neutral	Attractive
RRGB	Dangerous	Neutral
SHOO	Dangerous	Neutral
SPDC	Dangerous	Neutral
SSI	Dangerous	Neutral

Sources: New Constructs, LLC and company filings

We continue to use Cost of Debt as the underlying estimate because it reflects our treatment of Operating Lease Obligations as interest-bearing liabilities. Both FASB and IASB recently announced changes to requirements for company disclosure of lease obligations that align with New Constructs' view. In their announcement, both accounting standard bodies noted that the current standard fails "to meet the needs of users of financial statements because they do not always provide a faithful representation of leasing transactions" (link).

In the future, the fixed rate will change only when the cost of debt changes significantly. Ratings changes caused by a change in the Cost of Operating Lease Obligations will be flagged, and notices will be sent to all clients affected.

If you have any questions about the update, please contact us at support@newconstructs.com.

New Constructs® – Profile

How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensic accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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