



### Filing Season Finds: Wednesday, February 22

Forget all the “earnings season” analysis you read last month. The [real earnings season](#) – annual 10-K filing season – is happening right now.

Every year in this six-week stretch from mid-February through the end of March, we parse and analyze roughly 2,000 10-Ks to update our [models](#) for companies with a 12/31 fiscal year end. Our analysts work tirelessly to uncover [red flags hidden in the footnotes](#) and make our models the best in the business.

There’s no way we could analyze so many filings in such a short without our engineering team’s help. Using [machine learning and natural language processing](#), we automate much of the rote work of data gathering and modeling. Our technology frees our analysts up to spend more time on the complicated and unusual data points that other firms miss.

Investors [understand](#) that analyzing all financial statements and footnotes is an [essential part of the diligence](#) needed to fulfill the fiduciary duty of care. How else can one make the necessary adjustments to assess a company’s true earnings and return on invested capital ([ROIC](#))? Our innovation is to scale this diligence and make it easily accessible to our subscribers.

#### What We Accomplished Yesterday

Tuesday was the first day of filing season. Figure 1 shows the work our analysts did yesterday. As filing season goes on, we’ll compile the total amount of work performed by our analysts over the whole period.

**Figure 1: Filing Season Diligence**

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Today	56	7,941	1,335	\$351
Filing Season Total	56	7,941	1,335	\$351

Sources: New Constructs, LLC and company filings.

Yesterday, our analysts parsed 56 filings and collected 7,941 data points. In total, they made 1,335 [adjustments](#) with a dollar value of \$351 billion. That breaks down into:

- 577 income statement adjustments with a total value of \$24 billion
- 535 balance sheet adjustments with a total value of \$159 billion
- 223 valuation adjustments with a total value of \$168 billion

In particular, analyst Hunter Gray found an unusual item in Phillips 66’s (PSX) 10-K.

Like many big oil companies, PSX reports its inventories using the LIFO (Last In First Out) method rather than the FIFO (First In First Out) method preferred by most public companies. Utilizing LIFO increases cost of goods sold during times of rising oil prices, allowing PSX to report lower profits to the IRS and pay lower taxes.

Fortunately, GAAP rules require companies using LIFO to disclose what the inventory balance would have been if the company had used FIFO. This value, called the LIFO reserve, makes it possible for us to convert LIFO inventory and cost of goods sold to their FIFO equivalent.

In 2016, rising oil prices caused PSX’s [LIFO reserve to increase](#) by [\\$2 billion](#) (129% of reported GAAP net income!). PSX reported an earnings per share decline of over 60% in 2016. Our adjustments revealed that true after-tax profit ([NOPAT](#)) actually increased by 50%.

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*Disclosure: David Trainer, Hunter Gray, and Sam McBride receive no compensation to write about any specific stock, sector, style, or theme.*

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### ***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.

### ***Additional Information***

Incorporated in July 2002, [New Constructs](#) is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. [NOPAT](#), [Invested Capital](#), and [WACC](#), to create [economic earnings models](#), which are necessary to understand the true profitability and valuation of companies. Visit the [Free Archive](#) to download samples of our research. New Constructs is a [BBB accredited](#) business and a member of the [Investorside Research Association](#).



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