



## Filing Season Finds: Wednesday, March 8

Our latest forensic accounting red flag is from a biotechnology company whose surging stock price brings with it a significant hidden liability.

We pulled this highlight from yesterday's research of 104 10-K filings, from which our [robo-analyst](#) technology collected 12,874 data points. Our analyst team used this data to make 2,194 forensic accounting [adjustments](#) with a dollar value of \$117 billion. The adjustments were applied as follows:

- 943 income statement adjustments with a total value of \$7 billion
- 893 balance sheet adjustments with a total value of \$54 billion
- 358 valuation adjustments with a total value of \$55 billion

**Figure 1: Filing Season Diligence**

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Yesterday	104	12,874	2,194	\$117
Filing Season Total	1,361	195,988	33,378	\$12,060

Sources: New Constructs, LLC and company filings.

We believe this research is necessary to close the gap between the suitability and [fiduciary standard](#) of investment advice services.

### Today's Forensic Accounting Needle In A Haystack Is For Biotech Investors

Analyst Cody Fincher found an unusual item yesterday in Cytokinetics' (CYTK) 10-K.

On [page 121](#), CYTK discloses that it has 5.2 million outstanding employee stock options. Using the [Black-Scholes model](#), we estimate CYTK's [employee stock option liability](#) to be ~\$40 million (8% of market cap). When valuing CYTK, investors need to take into account the potential dilutive impact of these outstanding options.

Investors need to be wary of companies with large employee stock option liabilities. When the stock goes up significantly, as CYTK has today, that liability becomes more significant. If the stock drops rapidly, those options can become worthless and [make employee retention difficult](#).

*This article originally published [here](#) on March 8, 2017.*

*Disclosure: David Trainer, Cody Fincher, 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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