



Filing Season Finds: Thursday, March 8

For March 7, 2018, our forensic accounting red flag comes from a pharmaceutical company with a significant hidden liability.

We pulled this highlight from yesterday's research of 49 10-K filings, from which our [Robo-Analyst](#) technology collected 6,142 data points. Our analyst team used this data to make 1,001 forensic accounting [adjustments](#) with a dollar value of \$99 billion. The adjustments were applied as follows:

- 441 income statement adjustments with a total value of \$5 billion
- 395 balance sheet adjustments with a total value of \$49 billion
- 165 valuation adjustments with a total value of \$44 billion

Figure 1: Filing Season Diligence for Wednesday, March 7th

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Filing Season Day 12	49	6,142	1,001	\$99
Filing Season Total	1,307	202,217	32,151	\$11,815

Sources: New Constructs, LLC and company filings.

We believe this research is necessary to fulfill the [Fiduciary Duty of Care](#). Ernst & Young's recent white paper, "[Getting ROIC Right](#)", demonstrates how these adjustments contribute to meaningfully superior models and metrics.

Today's Forensic Accounting Needle in a Haystack Is for Pharmaceuticals Investors

The Robo-Analyst found an unusual item yesterday in Zogenix's (ZGNX) 10-K.

On [page 25](#) of the footnotes (page 95 overall), ZGNX includes a table detailing its stock option activity for 2017. At the end of 2017, the company had 3.4 million [outstanding employee stock options](#) with a weighted average exercise price of \$14.41/share, down from \$15.46/share at the end of 2016. Crucially, even as the exercise price of these options declined, ZGNX stock more than tripled in 2017, going from ~\$12/share to over \$40/share.

At the current stock price of ~\$44/share, the fair value of ZGNX's outstanding employee stock options is \$78 million (5% of market cap). Investors that don't account for these options are missing a significant source of future dilution and overvaluing the stock.

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

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To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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