



## Core Earnings & Earnings Distortion: Explanation & Examples

**Fact:** legacy data providers like S&P Global (SPGI) and Refinitiv miss material unusual gains/losses in footnotes that our [superior fundamental data](#) and earnings models catch.

**Proof:** [Core Earnings: New Data & Evidence](#), forthcoming in The Journal of Financial Economics.

Core Earnings ([as featured on CNBC Squawk Box](#)) measure the normalized operating profitability of a business. Accordingly, when calculating core earnings, analysts should strip out any gains/losses that are non-core, non-operating, or unusual.

### The Problem

Identifying unusual items that distort reported and consensus earnings has become increasingly difficult. Companies hide this information in the footnotes in ever more complicated ways. It's gotten so difficult to unravel, that most analysts and data providers don't do it. As a result, markets inefficiently measure earnings – as proven in The Journal of Financial Economics (JFE).

### The Answer

Our Robo-Analyst technology enables us to provide the best database of unusual items in the world and, as a result, provide the best measure of Earnings Distortion – as proven by the paper [Core Earnings: New Data and Evidence](#), forthcoming in The Journal of Financial Economics.

The paper empirically demonstrates that [our adjusted Core Earnings are meaningfully superior](#) to the best offerings from Refinitiv's IBES and S&P Global (SPGI), and "increasingly so over time" to quote the paper.

[Learn about our Earnings Distortion Score](#)

---

### Figure 1: How to Calculate Core Earnings

---

#### Total Revenue

- + Total Operating Income
- Total Reported Operating Expenses, Net
- + Total Hidden Non-Operating Expense, Net
- Reported Interest Expense/(Income), Net
- Reported Losses/(Income) from Unconsolidated Subsidiaries, Net
- Unreported Employee Stock Option (ESO) Expense
- Cash Taxes on Core Earnings
- Reported Minority Interest Expense, Net
- Reported Preferred Dividends, Net
- Reported Dividends on Redeemable Preferred Stock, Net

#### = Core Earnings

---

Sources: New Constructs, LLC and company filings

---

For more details on our calculation of Core Earnings, including the hidden and reported items we collect, we provide case studies [here](#). For details on the difference between the "Reported" and "Hidden" items, click [here](#). Note that data feeds with Earnings Distortion details are typically sold only to [Institutional members](#).



**Earnings Distortion = Net Income Minus Core Earnings**

Earnings Distortion is the non-core, non-operating, and unusual gains/losses that must be stripped out when calculating Core Earnings. It equals reported earnings minus Core Earnings. Figure 2 shows the key components of Core Earnings distortion. The higher the Earnings Distortion, the more overstated reported earnings are. The lower the Earnings Distortion, the more understated reported earnings are.

**Figure 2: Components of Earnings Distortion**

- + Earnings Distortion from 13 Categories of Hidden Items, Net
- + Earnings Distortion from 13 Categories of Reported Items Pre-Tax, Net
- + Income Tax Distortion
- + Earnings Distortion from 2 Categories of Reported Items After-Tax, Net
- = Total Core Earnings Distortion, Net**

Sources: New Constructs, LLC and company filings

Figure 3 shows the “Hidden” items we display on the Core Earnings pages in our [company valuation models](#) on over 5,000 stocks.

**Figure 3: “Hidden” Items Details from our Models**

**Novartis AG (NVS)**

Analyst Notes : None

Overrides are currently inactive. To review overrides click on the [Overrides edit page](#).

● = marks items on this page that can be overridden

● = marks items on this page that have active overrides in effect

[Download CSV](#)

Values in Millions except per share amounts	2016	2017	2018	TTM (Y/Y)*
<b>Earnings Distortion from Hidden Items, Net</b>				
Earnings Distortion from Hidden Total Restructuring Expenses, Net	(\$531.00)	(\$579.00)	\$5,016.00	\$1,269.00
Earnings Distortion from Hidden Foreign Currency Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Hidden Other Real Estate Owned Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Hidden Acquisition and Merger Expenses, Net	\$53.00	\$0.00	(\$56.00)	(\$14.00)
Earnings Distortion from Hidden Legal Regulatory and Insurance Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Hidden Derivative Related Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Hidden Other Financing Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Hidden Other Non-Recurring Expenses, Net	(\$259.00)	\$92.00	\$0.00	(\$5.00)
Earnings Distortion from Hidden Recurring Pension Expenses, Net	(\$172.00)	(\$165.00)	(\$111.00)	(\$111.00)
Earnings Distortion from Hidden Non-Recurring Pension Expenses, Net	\$0.00	\$241.00	\$0.00	\$0.00
Earnings Distortion from Hidden Company Defined Other Expenses, Net	\$50.00	\$0.00	(\$464.00)	(\$116.00)
Earnings Distortion from Quarterly-Annual Classification Disclosure Adjustment	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from ESO Expense (Employee Stock Options)	\$0.00	\$0.00	\$0.00	\$0.00
<b>Core Earnings Distortion from Hidden Items Net</b>	<b>(\$859.00)</b>	<b>(\$411.00)</b>	<b>\$4,385.00</b>	<b>\$1,023.00</b>

Sources: New Constructs, LLC and company filings



Figure 4 shows the “Reported” items we display on the Core Earnings pages in our company valuation models on over 5,000 stocks.

**Figure 4: “Reported” Items Details from our Models**

**Novartis AG (NVS)**

Analyst Notes : None

Overrides are currently inactive. To review overrides click on the [Overrides edit page](#).

● = marks items on this page that can be overridden

● = marks items on this page that have active overrides in effect

[Download CSV](#)

Values in Millions except per share amounts	2016	2017	2018	TTM (Y/Y)*
<b>Earnings Distortion from Reported Items Pre-Tax, Net</b>				
Earnings Distortion from Reported Derivate Related Expenses, Net	(\$1.00)	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Other Financing Expenses, Net	(\$19.00)	(\$24.00)	(\$32.00)	(\$32.00)
Earnings Distortion from Reported Company Defined Other Non-Operating Expenses, Net	(\$417.00)	(\$362.00)	(\$1,045.00)	(\$2,540.00)
Earnings Distortion from Reported Acquisition and Merger Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Legal, Regulatory, and Insurance Related Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Expenses/(Income) from Discontinued Operations, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Foreign Currency Expenses, Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Non-Operating Other Real Estate Owned Expense/(Income), Net	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Other Non-Operating Expense/(Income), Net	(\$477.00)	(\$59.00)	(\$65.00)	(\$19.00)
Earnings Distortion from Reported Write-Downs (non-operating)	\$0.00	\$0.00	\$0.00	\$0.00
Earnings Distortion from Reported Restructuring Expenses, Net	\$7.00	\$12.00	\$0.00	\$0.00
Earnings Distortion from Reported Other Non-Recurring Expense/(Income), Net	\$0.00	\$0.00	(\$77.00)	(\$77.00)
Earnings Distortion from Goodwill Amortization Expense	\$0.00	\$0.00	\$0.00	\$0.00
<b>Core Earnings Distortion from Reported Items Pre-Tax, Net</b>	<b>(\$907.00)</b>	<b>(\$433.00)</b>	<b>(\$1,219.00)</b>	<b>(\$2,668.00)</b>

Sources: New Constructs, LLC and company filings

Clients who subscribe to our valuation models get access to all the data behind our calculations. Our models also provide [audit-ability of all data](#) back to the original 10-Ks and 10-Qs upon which our models are built.

**Analyzing Core Earnings & Earnings Distortion for the Overall Market**

We leverage our database of footnotes adjustments and calculation of Core Earnings to spot [trends](#) across the market. Core Earnings, over the trailing twelve months (TTM) period through 1Q21, fell below [S&P Global's](#) (SPGI) Operating Earnings for the first time since April 2020. Investors only looking at reported earnings would get a misleading picture of profitability across the market. Per Figure 5, SPGI Operating Earnings have been more volatile over the last ~18 months than our Core Earnings. More details are [in our report on this topic](#).



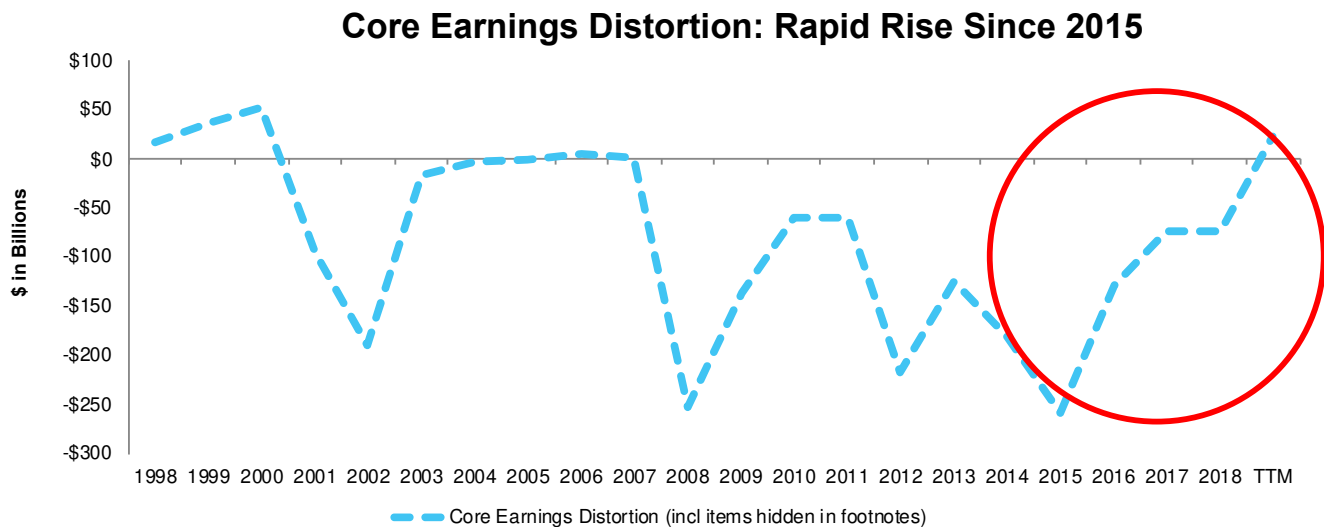
Figure 5: SPGI Operating Earnings vs. Core Earnings: Dec 2019-1Q21



Sources: New Constructs, LLC and company filings, and S&P Global (SPGI). Note: the most recent period's data for SPGI's Operating Earnings are based on consensus. Our Core Earnings analysis is based on aggregated TTM data through 6/30/13, and aggregated quarterly data thereafter for the S&P 500 constituents in each measurement period.

Figure 6 shows the level of Earnings Distortion from the unusual gains and losses since 2000. Note the rapid rise in the distortion from gains buried in footnotes over the last few years.

Figure 6: Core Earnings Distortion: Worst Since 2000 – Data Through November 18, 2019



Sources: New Constructs, LLC and company filings.

### Most Under/Overstated GAAP Net Income Vs. Core Earnings

Figure 7 shows the companies with the most under/overstated TTM Street Earnings per share (another flawed legacy earnings measure) as compared to Core Earnings per share as of 1Q21.

**Figure 7: Companies with Most Understated/Overstated TTM Earnings as of 1Q21**

Ticker	Name	Core EPS	Street EPS	Street Distortion
<b>Most Understated Earnings (\$ per share)</b>				
NVR	NVR Inc.	\$261.74	\$247.75	(\$13.99)
ALL	Allstate Corp	\$25.02	\$17.38	(\$7.64)
CB	Chubb Limited	\$13.60	\$7.14	(\$6.46)
HUM	Humana Inc.	\$27.08	\$21.01	(\$6.07)
WYNN	Wynn Resorts, Ltd	(\$13.97)	(\$18.04)	(\$4.07)
<b>Most Overstated Earnings (\$ per share)</b>				
AMP	Ameriprise Financial	(\$0.17)	\$16.87	\$17.04
AVGO	Broadcom Ltd	\$7.60	\$23.50	\$15.90
GOOGL	Alphabet, Inc.	\$62.67	\$75.12	\$12.45
BIIB	Biogen, Inc.	\$17.70	\$29.02	\$11.32
PRU	Prudential Financial	\$2.58	\$12.10	\$9.52

Sources: New Constructs, LLC and company filings.

Per Figure 7, Broadcom Ltd's (AVGO) Core Earnings are \$15.90 per share less than Street Earnings per share over the TTM period. Below, we explicitly reconcile Core Earnings to GAAP Earnings, but we cannot do the same for Street Earnings because analysts do not publicly disclose what is captured in Street Earnings. However, we know Street Earnings [often miss material unusual items](#) included in GAAP Earnings.

The large disconnect between GAAP earnings and Core Earnings stems from over \$250 million in gains from reported other non-operating income. These non-operating items include [\\$116 million](#) from lapse of indemnification, [\\$56 million](#) in other income, [\\$53 million](#) in interest income, and [\\$31 million](#) in gains on investments in 10-K 2020.

Ameriprise Financial (AMP), Alphabet, Inc. (GOOGL), Biogen, Inc. (BIIB), and Prudential Financial (PRU) also have significantly overstated Street Earnings after adjusting for unusual items.

On the other hand, NVR Inc.'s (NVR) Street Earnings per share (and GAAP Earnings for that matter) greatly understate its Core Earnings. NVR Inc. (NVR) took a [\\$25.6 million](#) impairment of deposits in its 2020 10-K. When combined with other non-core expenses, such as [\\$3 million](#) in interest hidden in cost of sales in the 2020 10-K, we see that NVR's Core Earnings of \$261.74/share are much higher than the \$247.75/share li Street Earnings.

Allstate Corp (ALL), Chubb Limited (CB), Humana Inc. (HUM), and Wynn Resorts, Ltd's (WYNN) Street Earnings understate the Core Earnings of their business operations in the TTM period. Although understated earnings alone don't mean a stock is worthy of investment, four of the five stocks with the most understated earnings in Figure 7 receive an [Attractive-or-better rating](#).

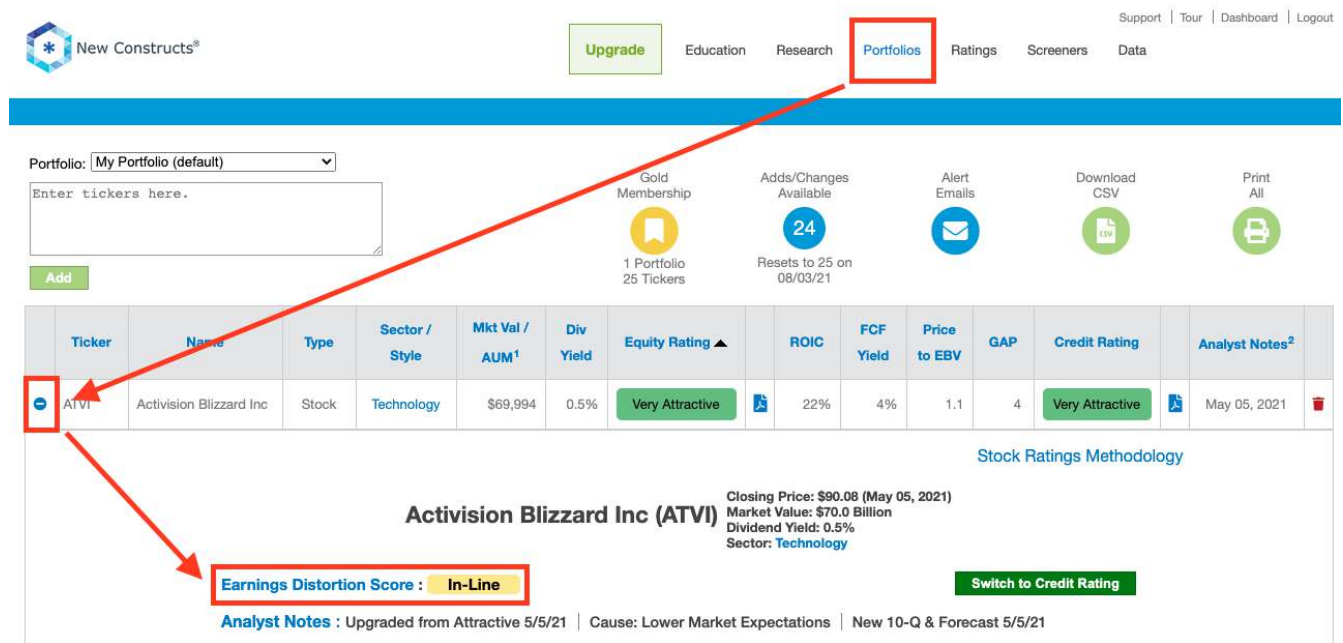
### Get Earnings Distortion Scores for All ~3000 Stocks Under Coverage

We leverage our Earnings Distortion measure to provide [Earnings Distortion Scores](#) for all stocks under coverage. These scores indicate how likely companies are to beat or miss expectations.

All members get our Earnings Distortion Scores for the stocks in their Portfolios by expanding the rating details using the "+" button in the first column of the Portfolio page, per Figure 8.



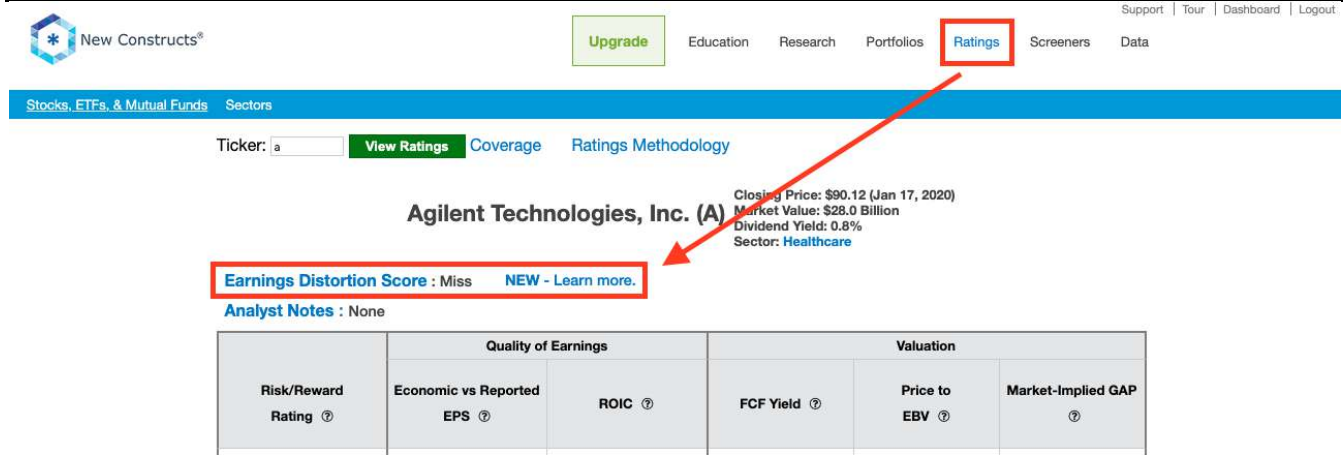
**Figure 8: Earnings Distortion Scores Available By Expanding Rating Details**



Sources: New Constructs, LLC and company filings

Platinum and higher members also get our Earnings Distortion Scores on the Ratings page. Per Figure 9, the Earnings Distortion Score will display above Analyst Notes on the Ratings page.

**Figure 9: Earnings Distortion Scores on the Ratings Page**



Sources: New Constructs, LLC and company filings



Institutional members get access to our Earnings Distortion tab on the Ratings page (and available via the Portfolios page). Per Figure 10, the Earnings Distortion tab displays more details about Earnings Distortion, such as historical Earnings Distortion, Earnings Distortion as a percent of different metrics, and more.

**Figure 10: Earnings Distortion Tab for Institutional Members**

Support | Tour | Dashboard | Logout

Education Research Portfolios **Ratings** Screeners Data

Stocks, ETFs, & Mutual Funds Credit Ratings Sectors

Ticker:  **View Ratings** Coverage Stock Ratings Methodology

**Agilent Technologies, Inc. (A)** Closing Price: \$149.49 (Jul 07, 2021)  
Market Value: \$45.4 Billion  
Dividend Yield: 0.5%  
Sector: Healthcare

Earnings Distortion Score : **In-Line** **Switch to Credit Rating**

Analyst Notes : None

Risk/Reward Rating ?	Quality of Earnings		Valuation		
	Economic vs Reported EPS ?	ROIC ?	FCF Yield ?	Price to EBV ?	Market-Implied GAP ?
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
<b>Neutral</b>	Neutral EE	3rd Quintile	<b>-1% &lt; 3%</b>	<b>1.6 &lt; 2.4</b>	10 < 20
Attractive	Positive EE	<b>2nd Quintile</b>	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	<b>Rising EE</b>	Top Quintile	> 10%	0 < 1.1	0 < 3
<b>Actual Values</b>					
<b>A</b>	<b>\$2.03 vs. \$2.99</b>	<b>11%</b>	<b>1%</b>	<b>2.3</b>	<b>52 yrs</b>
<b>Benchmarks ?</b>					
Sector ETF (XLV)	Positive EE	14%	2%	2.1	18 yrs
S&P 500 ETF (SPY)	Positive EE	26%	2%	2.8	25 yrs
Small Cap ETF (IWM)	Positive EE	4%	0%	3.7	40 yrs

**Add to Portfolio** **Company Model** **Download XLS** **Download Report** **Marked-Up Filings**

Investment Summary Rating Breakdown GAAP Reconciliation Adjustments **Earnings Distortion**

- ▶ Earnings Distortion Summary
- ▶ Core Earnings vs. Reported GAAP Earnings
- ▶ Earnings Distortion Per Share vs. GAAP EPS
- ▶ Earnings Distortion and Core Earnings Statistics (MM, except per share data)
- ▶ Earnings Distortion as Percentages

Sources: New Constructs, LLC and company filings

This article originally published on [January 13, 2020](#).

Disclosure: David Trainer, Kyle Guske II, Alex Sword, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.



## *It's Official: We Offer the Best Fundamental Data in the World*

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our “novel database” enables investors to overcome these flaws and apply [reliable](#) fundamental data in their research.
3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

### **Best Fundamental Data in the World**

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by S&P Global’s (*SPGI*) *Adjustments* individually.” – pp. 14, 1<sup>st</sup> para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2<sup>nd</sup> para.

### **Superior Models**

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [ as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5<sup>th</sup> para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2<sup>nd</sup> para.

### **Superior Stock Ratings**

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are [here](#).





## ***DISCLOSURES***

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

## ***DISCLAIMERS***

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs. Copyright New Constructs, LLC 2003 through the present date. All rights reserved.