



MicroStrategy's Outsized Bitcoin Holdings Distort Earnings

This report highlights MicroStrategy's (MSTR) chosen accounting treatment of its Bitcoin assets and how it impacted GAAP net income in 2020. Similar to what we saw with [Tesla's recent Bitcoin purchase](#), MicroStrategy's Bitcoin assets can be tools for earnings management.

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Bitcoin Treatment and Its Impact on Fundamentals

While analyzing MicroStrategy's 2020 10-K, analyst Devyn DeLange found that MicroStrategy accounts for its Bitcoin assets, which make up 72% of the firm's total assets, as indefinite-lived intangible assets instead of as short-term cash equivalents. This distinction means MicroStrategy will record [write-downs](#) on unrealized losses related to its Bitcoin assets as they fall in value. On the flip side, MicroStrategy can also record large, realized gains should it sell those assets after an increase in value. This accounting treatment is in contrast to how unrealized gains/losses are [recorded for equity securities](#).

In 2020, MicroStrategy recorded a [\\$71 million impairment charge](#) (nearly 2x MicroStrategy's 2020 [Core Earnings](#)) related to the firm's Bitcoin assets. In other words MicroStrategy's reported GAAP net income is massively understated due to its Bitcoin loss rather than any change in the firm's underlying operations. See disclosure of the firm's Bitcoin on its 2020 balance sheet [here](#).

Companies already use [numerous accounting loopholes](#) to manage earnings, and it appears Bitcoin investing is a new loophole.

Understanding Accounting Treatment to Better Manage Risk/Reward

Both equity and debt investors need to consider accounting details, which impact reported fundamentals, and how stakeholder capital is allocated¹.

In 2020, MicroStrategy's Bitcoin purchases were funded by sales of [short-term investments and the issuance of convertible bonds](#). On February 16, 2021, the firm [announced](#) its intentions to issue an additional \$600 million in 0% senior convertible notes, of which the proceeds will be used to purchase more Bitcoin. Just a day later, the firm [announced](#) it would increase the issuance to \$900 million.

It appears debtholders are willing to fund the firm's increased exposure to Bitcoin and will even do so at the [low interest rate](#) of 0%. However, shareholders appear more skeptical. MSTR fell 8% on February 16 (S&P fell >1%) after the initial announcement, which could indicate skepticism of the firm's plan to issue debt to purchase such a highly volatile and non-core asset, which can distort earnings.

We think investors' skepticism is warranted given that MicroStrategy, and its current CEO Michael Saylor, [previously settled](#) with SEC after it alleged the firm overstated its revenue and earnings in 1998 and 1999.

No Substitute for Diligence

We adjust for [all unusual items](#), both [hidden and reported](#), to calculate a [more accurate](#) measure of a firm's profitability. Going forward, we will remove any gains/losses firms realize when they sell Bitcoin from our calculations of profits, as these gains/losses represent [non-operating income/losses](#).

Without this diligence, investors could make misinformed investment decisions.

Only our "novel dataset", which leverages our [Robo-Analyst](#) technology, enables investors to overcome flaws with legacy fundamental datasets to apply [reliable fundamental data](#) in their research. [Core Earnings: New Data](#)

¹ A [study forthcoming in The Journal of Financial Economics](#) shows that most analysts and fundamental data firms do not pay enough attention to accounting details and footnotes disclosures when modeling earnings.



[& Evidence](#), accepted for publication by [The Journal of Financial Economics](#) also proves the superiority of our [fundamental data](#), [Core Earnings](#) models, and securities [research](#).

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

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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.
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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, 1st 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, 2nd 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, 5th 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, 2nd 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, 3rd para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3rd para.

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