



The Importance of Reading Footnotes – Filing Season 2022 Recap

During the [Real Earnings Season](#) (February 14 – March 18), our [Robo-Analyst](#)¹ analyzed 1,893 10-K and 10-Q filings, from which we collected 264,723 data points. This data led to 38,314 Core Earnings, balance sheet, and valuation [adjustments](#) with a combined dollar value of \$18.9 trillion. The adjustments were applied as follows:

- 15,752 income statement adjustments with a total value of \$1.2 trillion
- 14,942 balance sheet adjustments with a total value of \$8.4 trillion
- 7,620 valuation adjustments with a total value of \$9.4 trillion

Figure 1: Filing Season 2022 Productivity

	Filings Parsed	Data Points Collected	# of Adjustments	Total Value of Adjustments (\$Billions)
Filing Season Total	1,893	264,723	38,314	\$18,903

Sources: New Constructs, LLC and company filings.

This Filing Season Finds report highlights some of the most interesting footnote disclosures and largest [Earnings Distortions](#) we [haven't already featured](#) from the 1,893 10-Ks and 10-Qs we analyzed during filing season.

1. International Flavors & Fragrances' (IFF) understated profits don't make a good stock and
2. material disclosures in the 10-Ks of American Airlines (AAL), EnPro Industries (NPO), and more.

Since 2005, we've reported how traditional earnings measures are unreliable due to [accounting loopholes](#) that allow companies to [manage earnings](#). Our [Economic Earnings](#) and [Core Earnings](#) research closes those loopholes and provides [more reliable](#)² analysis of profits that also deliver a [new source of alpha](#).

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Understated Profits Aren't Always a Good Investment

In International Flavors & Fragrances' (IFF) 2021 10-K, our analyst Hunter Anderson highlighted how our Robo-Analyst found \$631 million in net non-operating items on page 44, which consisted of:

- [\\$368 million](#) in Nutrition and Biosciences (N&B) inventory step-up costs
- [\\$101 million](#) in N&B integration related costs
- [\\$91 million](#) in N&B transaction related costs
- [\\$42 million](#) in business divestiture costs
- [\\$29 million](#) in employee separation costs
- [\\$13 million](#) in **gains** on business disposal
- [\\$7 million](#) in shareholder activism related costs
- [\\$4 million](#) in Frutarom integration related costs
- [\\$2 million](#) in acquisition related costs

These non-operating charges are not on the income statement. They can only be found with careful analysis of footnotes, which many analysts and investors tend not to do. After removing these non-operating items and other Earnings Distortions (net -\$530 million, or 198% of GAAP earnings), we reveal that International Flavors &

¹ See Harvard Business School case: [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

² Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).



Fragrances' 2021 Core Earnings of \$798 million, or \$3.28/share, are much higher than GAAP earnings of \$268 million, or \$1.10/share.

Despite higher profits than GAAP earnings indicate, International Flavors & Fragrances earns an Unattractive [Stock Rating](#). Profits are an indication of a good *business*, but a good business is not worth buying at a bad *price*. At its current price, IFF's price-to-economic book value ([PEBV](#)) ratio is 4.4. This ratio means the market expects International Flavors & Fragrances profits to grow over 4x from current levels. Buying stocks with such lofty expectations already baked into their price leaves little room for upside potential and greater risk for downside.

Other Material Earnings Distortions & Insights

From disclosures in the footnotes and MD&A:

American Airlines (AAL) – Losses Still Bigger Than You May Realize

- In American Airlines' 2021 10-K, analyst Sam Moorhead noted that on [page 114](#) our Robo-Analyst found that the company bundled \$539 million in PSP Financial Assistance in the "Special Items, net" line on its income statement. We remove this non-operating income from our measure of NOPAT and Core Earnings to calculate the true recurring profits of the business. After removing all Earnings Distortions (\$3.5 billion, or 173% of GAAP earnings), we reveal that American Airlines' 2021 Core Earnings of -\$5.4 billion, or -\$8.46/share, are even worse than GAAP earnings of -\$2.0 billion, or -\$3.09/share.

EnPro Industries (NPO) – Hidden Gains Boost Reported Profits

- In EnPro Industries' 2021 10-K, analyst Robbie Woodward noted that our Robo-Analyst found a [\\$135 million](#) gain on the sale of businesses reported as an operating gain in EnPro's cash flow statement. After removing all Earnings Distortions (net \$197 million, or 111% of GAAP earnings), including \$132 million in "other income" reported on the income statement, we reveal that EnPro's 2021 Core Earnings of -\$20 million, or -\$0.97/share, are much worse than GAAP earnings of \$177 million, or \$8.52/share.

These Companies Need to Clean Up Reporting Processes

- [Last week](#), we highlighted our Robo-Analyst finding that Research Frontier's (REFR) independent auditor identified a material weakness in internal control over financial reporting, but it wasn't the only company. In fact, our Robo-Analyst found 18 other companies that disclosed material weaknesses in their internal controls in their 2021 10-Ks. These companies include:
 - 3D Systems (DDD)
 - Advaxis (ADXS)
 - Cardlytics (CDLX)
 - CBRE Group (CBRE)
 - Coupang (CPNG)
 - Encore Capital Group (ECPG)
 - Garrett Motion (GTX)
 - Gold Resource Corp (GORO)
 - Gray Television (GTN)
 - IHS Holding Limited (IHS)
 - Myriad Genetics (MYGN)
 - Par Technology Corp (PAR)
 - Pennsylvania Real Estate Investment Trust (PEI)
 - Peoples Bancorp (PEBO)
 - SeaWorld Entertainment (SEAS)
 - Shenandoah Telecommunications (SHEN)
 - SPX Corporation (SPXC)
 - MDC Partners (STGW)

Weaknesses in internal controls increase the risk that the company's financials are fraudulent and misleading. Identifying this risk is necessary due diligence for every investment decision-making process.

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Disclosure: David Trainer, Hunter Anderson, Sam Moorhead, Robbie Woodward, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

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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, 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.

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](#).



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