



All Cap Index & Sectors: GAAP Earnings Continue Fall in 3Q22 (Free, Abridged)

3Q22 GAAP earnings for the NC 2000¹ continued to drop from record levels reached in 1Q22 and remain lower than [Core Earnings](#) for the second consecutive quarter. Six out of eleven sectors saw a quarter-over-quarter (QoQ) rise in Core Earnings through the trailing-twelve-months (TTM) ended 3Q22, the same number as 2Q22.

This report is an abridged and free version of [All Cap Index & Sectors: GAAP Earnings Continue Fall in 3Q22](#), one of our quarterly reports on [fundamental market and sector trends](#).

The full version of the report analyzes [Core Earnings](#)²³ and GAAP earnings of the NC 2000 and each of its sectors (last quarter's analysis is [here](#)). The full reports are available to those with our new [Professional](#) (previously known as [Unlimited](#)) or [Institutional](#) memberships. The reports are also available for purchase below.

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Core Earnings Are More Reliable than GAAP Earnings

Figure 1 in the [full report](#) shows GAAP Earnings for the NC 2000 understated Core Earnings for the second consecutive quarter, after spiking to record levels in the TTM ended 1Q22. This drop in GAAP Earnings relative to Core Earnings follows the pattern that preceded the Great Recession.

Corporate profits, as measured by Core Earnings, have been much less volatile than GAAP earnings suggest, especially since 1Q20. For example, per Figure 1, in the TTM ended:

- 1Q21, GAAP earnings rose 44% QoQ compared to a 15% rise for Core Earnings.
- 2Q22, GAAP earnings fell 6% QoQ compared to a 2% rise in Core Earnings
- 3Q22, GAAP earnings fell 2% QoQ compared to a 1% rise for Core Earnings.

Figure 1: NC 2000 Core Earnings Vs. GAAP Earnings QoQ Percent Change: 1Q20 – 3Q22



Sources: New Constructs, LLC and company filings.

Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

The November 25, 2022 measurement period incorporates the financial data from 3Q22 10-Qs, as this is the earliest date for which all of the calendar 3Q22 10-Qs for the NC 2000 constituents were available.

¹ The NC 2000 consists of the largest 2000 U.S. companies by market cap in our coverage. Constituents are updated on a quarterly basis (March 31, June 30, September 30, and December 31). We exclude companies that report under IFRS and non-U.S. ADR companies.

² Core Earnings enable investors to overcome the flaws in legacy fundamental data and research, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan for [The Journal of Financial Economics](#).

³ Based on the latest audited financial data, which is the 3Q22 10-Q in most cases. Price data as of 11/25/22.



This report leverages our cutting-edge [Robo-Analyst technology](#) to deliver [proven-superior](#)⁴ fundamental research and support more cost-effective fulfillment of the [fiduciary duty of care](#).

GAAP Earnings Understate Core Earnings for More Than Half of the NC 2000⁵

For the TTM ended 3Q22, 62% of the companies in the NC 2000 reported GAAP Earnings that understated Core Earnings. The 1,239 companies with understated GAAP earnings make up 56% of the market cap of the NC 2000.

When GAAP Earnings understate Core Earnings, they do so by an average of 79%, per Figure 2. GAAP Earnings understate Core Earnings by more than ten percent for 32% of companies. For comparison, in the TTM ended 2Q22, 1,183 companies had understated GAAP earnings.

Figure 2: NC 2000 GAAP Earnings Understated by 79% On Average

| Understated GAAP Earnings | Understated by >10% | Average Understatement % |
|---------------------------|---------------------|--------------------------|
| 1,239 companies | 648 companies | 79% |

Sources: New Constructs, LLC and company filings.
We use Funds from Operations (FFO) for Real Estate companies rather than GAAP Earnings.

Key Details on Select NC 2000 Sectors

The Energy sector saw the largest QoQ improvement in Core Earnings, which rose from \$203.0 billion in 2Q22 to \$260.9 billion in 3Q22, or 29%.

At \$466.3 billion, the Technology sector generates the highest Core Earnings, and saw Core Earnings fall 3% QoQ in 3Q22. On the flip side, the Real Estate sector has the lowest Core Earnings at \$36.8 billion, and the Financials sector had the largest QoQ decline in 3Q22 at -7%.

Below we highlight the Consumer Cyclical sector and a stock with some of the most negative Earnings Distortion (i.e. understated GAAP earnings) in the sector.

Sample Sector Analysis⁶: Consumer Cyclical

Figure 3 shows Core Earnings for the Consumer Cyclical sector rose 1% QoQ to \$219.5 billion in 3Q22, while GAAP earnings fell 5% QoQ to \$218.7 billion over the same time.

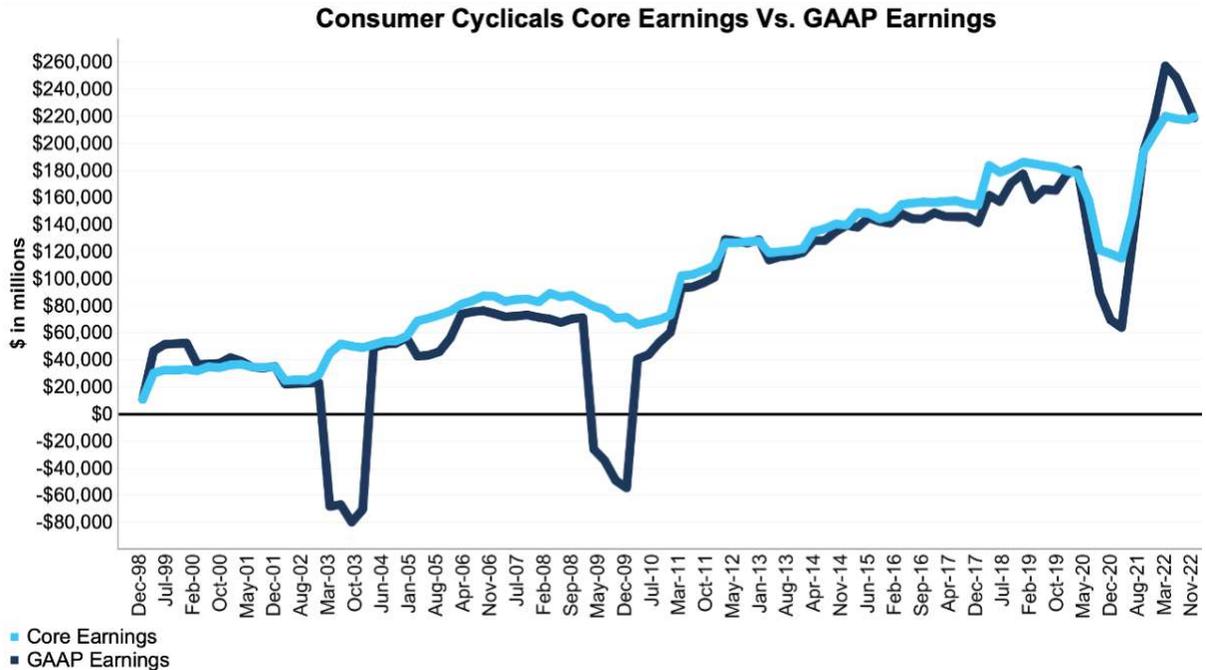
⁴ Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).

⁵ Understated companies include all companies with Earnings Distortion <-0.1% of GAAP earnings.

⁶ The full version of this report provides analyses for all eleven sectors.



Figure 3: Consumer Cyclical Core Earnings Vs. GAAP: 1998 – 3Q22



Sources: New Constructs, LLC and company filings.

Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.

The November 25, 2022 period incorporates the financial data from calendar 3Q22 10-Q, as this is the earliest date for which all of the calendar 3Q22 10-Qs for the NC 2000 constituents were available.

GAAP Earnings Understatement Details: PulteGroup (PHM)

Below, we detail the [hidden and reported](#) unusual items that GAAP Earnings miss but that we capture in Core Earnings for PulteGroup. After adjusting for unusual items, we find that PulteGroup’s Core Earnings of \$2.6 billion, or \$10.60/share are much higher than reported GAAP Earnings of \$2.4 billion, or \$9.83/share.

PulteGroup’s [Earnings Distortion Score](#) is Beat and its Stock Rating is Very Attractive, in part due to its return on invested capital ([ROIC](#)) of 17% and price-to-economic book value ([PEBV](#)) ratio of 0.3.

Below, we detail the differences between Core Earnings and GAAP Earnings so readers can audit our research.

Figure 4: PulteGroup’s GAAP Earnings to Core Earnings Reconciliation: TTM Through 3Q22

| | TTM 3Q22 (\$ per share) |
|--|-------------------------|
| GAAP Net Income | \$9.83 |
| – Hidden Unusual Expenses, Net | (\$0.56) |
| – Reported Unusual Expenses Pre-Tax, Net | (\$0.12) |
| – Tax Distortion | (\$0.02) |
| – Reported Unusual Expenses After-Tax, Net | (\$0.07) |
| = Core Earnings | \$10.60 |

Sources: New Constructs, LLC and company filings.

More details:

Total Earnings Distortion of -\$0.77/share, which equals -\$185 million, is comprised of the following:

Hidden Unusual Expenses, Net = -\$0.56/per share, which equals -\$135 million and is comprised of

- -\$159 million in interest expensed in the TTM period based on
 - [\\$41 million](#) in 3Q22
 - [\\$38 million](#) in 2Q22
 - [\\$34 million](#) in 1Q22



- [\\$46 million](#) in 4Q21
- [\\$25 million](#) in adjustments to previously recorded reserves in 4Q21

Reported Unusual Expenses Pre-Tax, Net = $-\$0.12$ /per share, which equals $-\$29$ million and is comprised of

- $-\$38$ million in write-offs of deposits and pre-acquisition costs in the TTM period based on
 - [-\\$24 million](#) in 3Q22
 - [-\\$5 million](#) in 2Q22
 - [-\\$4 million](#) in 1Q22
 - [-\\$5 million](#) in 4Q21
- $\$9$ million in miscellaneous income in the TTM period based on
 - [\\$1 million](#) in 3Q22
 - [\\$3 million](#) in 2Q22
 - [\\$3 million](#) in 1Q22
 - [\\$2 million](#) in 4Q21

[Tax Distortion](#) = $-\$0.02$ /per share, which equals $\$4.6$ million

Reported Unusual Expenses After-Tax, Net = $-\$0.07$ /per share, which equals $\$17$ million and is comprised of

- $-\$16$ million in undistributed earnings allocated to participating securities in the TTM period based on
 - [-\\$4 million](#) in 3Q22
 - [-\\$4 million](#) in 2Q22
 - [-\\$3 million](#) in 1Q22
 - [-\\$6 million](#) in 4Q21
- $-\$0.9$ million in earnings distributed to participating securities in the TTM period based on
 - [-\\$0.2 million](#) in 3Q22
 - [-\\$0.2 million](#) in 2Q22
 - [-\\$0.2 million](#) in 1Q22
 - [-\\$0.3 million](#) in 4Q21

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

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Appendix: Calculation Methodology

We derive the Core Earnings and GAAP Earnings metrics above by summing up the trailing-twelve-month individual NC 2000 constituent values for Core Earnings and GAAP Earnings in each sector for each measurement period. We call this approach the “Aggregate” methodology.

The Aggregate methodology provides a straightforward look at the entire sector, regardless of market cap or index weighting and matches how S&P Global (SPGI) calculates metrics for the S&P 500.



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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.

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