Investing Insights 2022

The Winkler Group's annual report on global investing trends

Powered by:

New Risk Alerts

Our core research product that uncovers subtle but key changes in SEC filing language and footnotes to provide actionable investing insights.

Contents

Investing Insights 2022

New Risk Alerts

Discovering needles in SEC filing haystacks.

$69.1 Billion

in accounting distortions exposed

7,231

Filings scanned

186

New Risk Alerts published

Hidden Liabilities | Revenue Recognition Changes | Earnings Quality Issues
Accounting Policy Changes | New Profitability Metric Calculations

First To Know

New Risk Alert subscribers get market moving insights long before they make headlines.

Netflix (NFLX)

Six weeks before *The Wall Street Journal*, *Financial Times*, and *Bloomberg* broke news about Netflix's password sharing crackdown, subscribers were warned the company planned to target abusive account sharing.

- Netflix Telegraphs New Price Increases & Signals Account Sharing Crackdown

Tesla (TSLA)

One month prior to news breaking that investigators are probing the role Tesla's autopilot technology may have played in three crashes, subscribers were warned Tesla is de-emphasizing the technology and no longer featuring it as prominently in its latest annual report.

- Tesla Warns Self-Driving Technology Still Under Development, No Longer Featuring It As Prominently

Centene (CNC)

Two weeks before *The Wall Street Journal* reported on the multi-state probe into several pharmacy benefits managers, subscribers were first to know when we published New Risk Alerts on CVS and Centene.

- Centene Accused of Double Billing, Inflating Prescription Drug Costs

VMware (VMW)

Two weeks before *The Wall Street Journal*, *Financial Times*, and *Bloomberg* reported VMware (VMW) would pay an $11.5 billion special dividend in connection with its spinoff from Dell, subscribers were first to know.

- VMware Warns of Market Coalescence, New Competition

Most Popular

Our annual top five most clicked on, read, and forwarded ***New Risk Alerts***.

✔ Hovnanian CEO Paid $14.8 Million to a Family Member Who Advises a Regulator Suing the Homebuilder

Consultant promises to recuse himself from the matter following our inquiry regarding the conflict of interest.

✔ Google Removes Claim That Its Artificial Intelligence Helps Detect Cancer Earlier

We've requested the names of the doctors who allegedly used Google's AI to detect cancer earlier so we can verify Google's now omitted claim.

✔ Facebook's Messaging Encryption Claims Contradicted

The Winkler Group has contacted Facebook and asked it to reconcile Zuckerberg's contradictory encryption claims.

✔ QuantumScape, a Solid-State Imposter, Signals Delay in Battery Commercialization

Battery firm omits language regarding the development of solid catholytes, signals one year delay in commercialization.

✔ Grocery Outlet Leases Jet From Its CEO in Deal Approved by a Cousin

If a jet is necessary because stores are not easily accessible by car, how are customers supposed to drive there?

Stocks to Watch

Here we flag 18 stocks in six key categories deserving of added investor scrutiny in 2022:

Revenue Recognition Watch

Companies that change revenue recognition policies, aggressively recognize revenue not yet generated, or telegraph slower sales growth.

✔ Prologis Recognizes Revenue From Rental Payments Not Yet Made

The logistics and fulfillment firm deferred rental payments it was owed during the pandemic but continued recognizing non-existent payments as revenue.

✔ Meritage Homes Recognizes Revenue From Insurance Policies Not Yet Renewed

Homebuilder assumes insurance policies will be renewed and immediately recognized renewals as revenue after initial policy is issued.

✔ Netgear Telegraphs Price Cuts, Slower Revenue Recognition

Networking gear firm hints it may "modify" its standalone selling price estimates while simultaneously offering more liberal contract terms that will negatively impact revenue recognition.

Earnings Distortion Watch

Companies that inflate earnings, hide liabilities, or change how preferred profitability metrics are calculated.

✔ Avalara Restates Cash Flows, Understates Lease Liability by $7.7 Million

Our analysis indicates restatements negatively impacted operating cash flows and reveals the software maker is hiding certain liabilities from investors.

✔ Fleetcor Inflates Net Income by $102 Million With New Calculation Method

Investors relying on Fleetcor's non-GAAP net income calculation are getting a misleading picture of the company's financial performance.

✔ Toro's Off-Balance Sheet Credit Exposure Spikes as Receivables Outpace Sales

Off-balance sheet receivables are growing much faster than sales as the turf equipment maker's revenue from a key joint venture falls short of expectations.

Internal Controls Watch

Companies that have identified material weaknesses in internal controls over financial reporting (ICFR), belatedly disclose them, or are not remediating them in a timely manner.

✔ Blink Charging: Lingering Control Deficiencies, Penny Stock Scheme Ties, & Hush Money Settlements

One year after promising a fix, electric vehicle charging firm's control deficiencies have not been remediated despite company's claim of substantial progress.

✔ Fastly Warns of Improper Accounting Due to Material Weakness in Internal Controls

Three months after we highlighted Fastly's accounting issues, the company's CFO resigned and shares had declined 41.9%.

✔ Tattooed Chef Reveals Previously Undisclosed Internal Control Deficiency

Three months after revealing the plant based frozen food company "adjusted" its 2020 net income upward 34% nine days after reporting it, a sixth previously undisclosed control deficiency was revealed.

Regulatory Watch

Companies under regulatory scrutiny in the United States and abroad.

✔ J.P. Morgan Under Investigation by Multiple Unnamed Regulators

Buried in the footnotes is a warning that Jamie Dimon's bank is being ordered by multiple regulators to preserve electronic communications.

✔ PayPal Under SEC Investigation, Now a Target in Three Federal Probes

Revelations follow news that PayPal is already under investigation over unauthorized money transfers and collections processes.

✔ Invitation Homes Under Investigation For Possible Eviction Moratorium Violations

Home builder is allegedly one of several firms that illegally evicted tenants during pandemic ban.

Legal Watch

Companies that have received subpoenas, civil investigative demands, or requests for information by law enforcement agencies.

✔ Cadence Design Systems Hides Federal Subpoena for Five Months

Integrated circuit designer under investigation for possible illegal sales to China.

✔ CVS Accused of Illegally Inflating Prescription Drug Prices

The pharmacy benefits manager (PBM) has received so many CIDs, it now refers to them by the month they were received.

✔ Cisco Discloses Investigation Into Chinese Kickback Scheme

Technology firm under investigation for allegedly bribing Chinese officials affiliated with state owned firms.

Competition Watch

Companies experiencing increased competition, a decline in their value proposition, or have offerings at risk of being commoditized.

✔ KLA Signals Competitors May be Poaching Its Customers

Process control and yield management firm omits key language that dates back six years.

✔ Elastic's Sales to Existing Customers Slow After War With Amazon

Data search firm introduces new key metric calculation six months after picking a fight with Amazon.

✔ Sonos Omits Reference to Apple & Amazon, Doubles Down on Direct-to-Consumer

Long time distribution partners being alienated by audio firm's focus on selling direct.

Trends 2022

Five emerging trends and the catalysts we expect will accelerate them in 2022.

TREND 1

The ESG Spotlight Shifts To Governance

SUMMARY

Expect governance to take center stage as ESG proponents look for new ways to legitimize their evaluation methodologies and scores. The lesser known of the ESG factors, governance is well positioned to become the connective tissue between multiple secular trends; new audit requirements for Chinese companies, increased disclosure and accounting standards for SPACs, and heightened regulatory scrutiny of cryptocurrencies.

IMPACT

We've uncovered more than **$12.7 billion** in questionable governance in the popular electric vehicle (EV), SPAC, and battery technology spaces in just the first three quarters of 2021.

✔ Romeo Power's Ousted CEO to Receive Nearly $1 Million After Misleading Investors

Romeo signs first Tier-1 long-term battery supply agreement five months after ousted CEO suggested there were two.

✔ Canoo Reimburses CEO $561,000 for Personal Jet Use, Understates Lease Liability by 6.9%

Executives use the EV SPAC as a personal piggy bank while hiding millions in liabilities from investors.

✔ Fisker's Insider Deals Inflate Share Count 1.3%, Dilute Investors

EV SPAC cut in half as it appoints insider board and hires board member's relative as a consultant.

CATALYSTS

Expect governance to increasingly play a larger role in the ESG narrative as investors with significant losses in highly rated ESG SPACs— those that trade below their IPO price— place less emphasis on or ignore ESG ratings as they see SPAC sponsors exit with windfalls.

TREND 2

New Useful Life Estimates as Inflation Hedges

SUMMARY

Expect companies to extend their useful life estimates to preserve margins if inflation continues to rise. Though the accounting change does nothing to lift economic earnings or cash flows, slowing depreciation schedules adds to reported earnings and can offset rising costs that would otherwise pressure margins.

IMPACT

We've tracked more than **$5.1 billion** in additional reported earnings as a result of companies extending their useful life estimates:

✔ Accounting Change to Inflate Google's 2021 Earnings by $2.1 Billion

We estimate the firm will report EPS 5% higher than the GAAP consensus forecast.

✔ UPS to Add Estimated $60 Million to Operating Income With New Useful Life Estimate

We estimate the potential to recognize an additional $33 million in operating income in 2021.

✔ Microsoft Adds $500 Million to Net Income With Accounting Change

The change preserved gross margin growth and added $0.07 to quarterly EPS.

From office furniture to servers, adjusting useful life estimates will enable companies to instantly offset at least a portion of increased commodity, labor, and logistics costs. Higher than expected or persistent inflation is a catalyst we suspect will cause many to follow the lead of the world's largest companies.

CATALYSTS

Expect companies that have historically had difficulty passing on higher costs to price sensitive shoppers to adjust useful life estimates and preserve net income margins without raising prices commensurate with inflation. The change will also benefit industries where price realization often lags inflation by two or three quarters. Though not a long term solution, extended useful life estimates insulate net income margins for a year, after which inflationary comps are likely to moderate.

TREND 3

Weaponizing Discount Rates to Hide Liabilities

SUMMARY

Expect companies to understate liabilities by using inflated operating lease discount rates. Using an inflated discount rate reduces the present value of future lease payments and hides a firm's true liabilities from investors. If rates rise, companies will have the cover necessary to further lift discount rates and make balance sheets appear healthier than they are.

IMPACT

We've uncovered more than **$5.8 billion** in hidden liabilities as a result of inflated discount rates so far this year:

✔ Walmart Understates Lease Liability by $2.1 Billion

Retailer's discount rate is 56.4% higher than its borrowing rate.

✔ Asana Understates Lease Liability by $108.3 Million, Or 28.3%

SaaS provider's discount rate rises nearly 180% from prior year.

✔ MercadoLibre Understates Liabilities by $28.7 Million With a Discount Rate 3X Its Real Borrowing Rate

Ecommerce platform borrows in U.S. dollars but appears to calculate cost of capital and discount rates based on inflated foreign country bond rates.

The most inflated discount rates we've tracked top 13% and, in some cases, exceed the offending company's real borrowing rates. Inflated discount rates are a red flag that routinely result in the discovery of additional accounting issues. Conversely, we consider companies with modest discount rates for our Long List. The lowest discount rate we tracked to date this year is Workday (WDAY) at 1.73%. Tied for second best at 1.8% are VFC, AMAT, and PAYX.

CATALYSTS

Expect inflated discount rates to get even heftier if credit markets tighten and debt becomes more expensive to roll over. Though this scenario provides a legitimate reason to raise discount rates, investors should also expect higher discount rates if commercial real estate markets become oversupplied due to hybrid and work-from-home trends. If companies can't sublease office space they no longer need on favorable terms, an inflated discount rate can hide balance sheet weakness.

TREND 4

The Multi-Billion Dollar IP Shuffle Accelerates

SUMMARY

Expect companies to increasingly transfer intellectual property (IP) assets to lower tax jurisdictions to instantly create deferred tax assets (DTA) worth billions of dollars. New accounting standards (ASU 2016-16) now allow the immediate recognition of the income tax effect of intra-entity asset transfers other than inventory.

IMPACT

We've tracked more than **$6 billion** in DTAs created out of thin air that have helped some of the world's largest technology companies avoid paying taxes:

✔ Adobe Avoids Taxes With $1.3 Billion Game of Irish Chess

We estimate the digital experience platform saved $514 million in 2020 taxes which contributed to the $15 billion share buyback announcement one month later.

✔ Salesforce Earned $860 Million in 2020, Not $4 Billion

Our analysis reveals non-operating items distorted core annual earnings by more than $3 billion, or 373%.

✔ Oracle's IP Transfer Results in $2.3 Billion Tax Benefit

Shifting IP overseas reduced the enterprise IT firm's tax rate 69.7% to (53.3%) in a recent quarter.

With top technology firms reaping significant windfalls, we suspect smaller, less sophisticated firms to follow suit as the benefits become even more pronounced with new state and federal tax policies.

CATALYSTS

Expect accelerated intra-entity asset transfers as companies look for ways to offset less favorable tax policy changes like California's new law that suspends Net Operating Loss (NOL) deductions in 2022 for company's reporting more than $1 million of taxable income. Likewise, a higher U.S. federal corporate tax rate would increase the value of DTAs created by transferring assets to countries with lower tax rates.

TREND 5

Loophole Offers Legal Way to Hide Debt

SUMMARY

Expect companies to overstate balance sheet strength by hiding debt associated with operating leases “not yet commenced.” Leases that have not yet commenced must be disclosed but not necessarily included on the balance sheet. The accounting loophole allows companies to understate billions of dollars in liabilities.

IMPACT

We’ve uncovered more than **$3.8 billion** in not yet commenced leases being kept off-balance sheet thus far this year:

✔ Salesforce Adds $100 Million to Its Hidden Off-Balance Sheet Liabilities

CRM platform’s not yet commenced leases now top $1.5 billion.

✔ Twitter is Hiding a Half-Billion Dollar Liability Off-Balance Sheet

Social media platform’s not yet commenced leases increase by $102.2 million in ninety days.

✔ Bed Bath & Beyond’s Hidden Liabilities Now Top $200 Million

Retailer habitually manipulates operating lease calculations to understate true liabilities.

Under the loophole, companies can omit from the balance sheet leases that haven’t started as well as corporate offices under construction or build-to-suit arrangements. While excluding these liabilities is within the letter of the law, it seems inconsistent with the spirit of the new standard (ASU 2016-02) requiring companies to report operating leases on the balance sheet.

CATALYSTS

Expect companies to creatively include more and more in the “not yet commenced” category as managers' right-size office footprints to fit the new hybrid and work-from-home world. Likewise, we suspect companies may renegotiate terms related to new construction or build-to-suit arrangements if the commercial real estate sector finds itself oversupplied— lessening or delaying the debt burden that will eventually force its way onto the balance sheet. Expect leases to spend extra time off-balance sheet in the “not yet commenced” bucket should credit markets tighten and companies find themselves in danger of violating debt covenants or leverage ratios.

PERFORMANCE

New Risk Alerts

In 2021, we exposed $69.1 billion in accounting distortions to provide investors stock-specific, actionable insights.

Our work moved markets, made headlines, and preceded the departures of two CEOs and a CFO.

Get our best idea each week ***FREE***.

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