NEW RISK ALERT: (Accounting Shenanigans)

Non-Existent Revenue Recognized, Inflated Net Income, Understated Expenses & More

Inside this report, we expose $2.38 billion in accounting shenanigans.

About this report

This report exposes some of the most egregious accounting shenanigans disclosed in 2021. The research notes included here were originally published as ***New Risk Alerts***, a research service that uncovers subtle but key changes in SEC filing language to reveal new information before it moves markets. Offered together in one report for the first time, New Risk Alerts: (Accounting Shenanigans) provides powerful insights traditional Wall Street research services miss, overlook, or ignore.

Powered by ***The Winkler Group***, our technology and team scan filings and footnotes to save you time, provide actionable investment ideas, and uncover new insights like:

- *How an accounting policy change will inflate Google's earnings by $2.1 billion*
- *How Intuit's creative accounting overstates segment operating results by $148 million*
- *How Live Nation justifies not recognizing $36.9 million in sunk ad expenses*
- *How Fleetcor changed a key metric calculation to boost net income by $102 million*
- *How Meritage Homes explains recognizing revenue on non-existent insurance policy renewals*

In all, this report uncovers $2.38 billion in accounting shenanigans buried in filings most Wall Street analysts help hide, overlook, or ignore.

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NEW RISK ALERT: (INTU)

Intuit Removes $148 Million in Costs From Segment Operating Results

New language in latest 10-Q also reveals inconsistencies in company's segment accounting treatment.

Published February 26, 2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Intuit Strips Out $148 Million in Costs, Inflating Segment Operating Income

Intuit, a provider of tax, accounting, and financial management software to small businesses and individuals, recently stripped out many of the costs it once included in its segment operating results. In its Q2 FY2021 10-Q, Intuit disclosed it has reorganized certain technology and customer success functions and that:

> *"...certain legal, facility and employee service costs are now managed at the corporate level."*

Instead of including these costs in segment operating results, Intuit now accounts for them as other corporate expenses. In its latest quarterly report, Intuit quantified the costs it has reclassified:

> *"For the three and six months ended January 31, 2020, we reclassified $45 million and $88 million from Small Business & Self-Employed, $28 million and $53 million from Consumer, and $4 million and $7 million from ProConnect to other corporate expenses."*

Though not an uncommon practice, reclassifying $148 million (last 6 months) as corporate expenses distorts segment operating results and margins. If we add back the costs, we calculate Intuit's new presentation overstates segment operating income by:

- Small Business & Self-Employed: 6.5%
- Consumer: 35%
- ProConnect: 4.3%

In total, the $148 million is 10.5% of Intuit's total segment operating income.

Intuit Inconsistent in Its Segment Accounting Treatment

Not only does the reclassification make comparing segments to competitors difficult, it's also harder to compare them with Intuit's fourth segment, Credit Karma, which was acquired in December 2020. Instead of allocating Credit Karma's expenses consistent with other segments, Intuit includes the expenses in Credit Karma's operating results:

> *"Segment operating income for Credit Karma includes all direct expenses related to selling and marketing, product development, and general and administrative,* ***which is different from our other reportable segments*** *where we do not fully allocate corporate expenses. Therefore, Credit Karma segment operating income* ***is not comparable to the segment operating income of our other reportable segments****."*

To further distort segment operating results, Intuit disclosed it excludes the following costs from all four segments:

> *"Unallocated corporate items for all segments include share-based compensation, amortization of acquired technology, amortization of other acquired intangible assets, and goodwill and intangible asset impairment charges."*

NEW RISK ALERT: (LYV)

Live Nation Not Expensing an Estimated $36.9 Million in Ad Costs for Cancelled Concerts

New 10-K reveals concert promoter won't expense marketing costs until events are rescheduled.

Published March 8, 2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Accounting Change Pushes Expenses Into Future

Live Nation Entertainment, a live entertainment and ticketing company, halted all concert tours and closed all of its venues for much of 2020 due to the pandemic. Revenue plunged 84% and resulted in an operating loss of $1.7 billion in 2020. The result would have been worse if not for an accounting change.

In its 2019 10-K, Live Nation disclosed that concert advertising costs are expensed in the year they occur:

> *"All advertising costs incurred during the year for shows in future years are expensed at the end of the year."*

In its 2020 10-K, Live Nation keeps the prior year's language, then seemingly contradicts it by disclosing it's now pushing advertising costs for cancelled events into the future:

> *"All advertising costs incurred during the year for shows in future years are expensed at the end of the year. **If a current year event is rescheduled into a future year, all advertising costs incurred to date are expensed in the period when the event is rescheduled**."*

It's not surprising Live Nation would want to match future concert revenue with associated expenses. But pushing ad expenses incurred in 2020 into future periods understates Live Nation's 2020 operating loss. The company acknowledges this when explaining the 89% decline in total fan count in 2020:

> *"Concerts had an operating loss for the year largely due to lost business resulting from the global COVID-19 pandemic and from **sunk costs, such as advertising expenses**, associated with shows cancelled or rescheduled to 2021."*

Our Analysis Reveals $36.9 Million in Sunk Ad Costs Not Yet Recognized

How much was sunk but not recognized? Live Nation doesn't make it easy to determine. First, the company doesn't break out "general" advertising expenses, which are expensed when incurred, from "event-related" advertising, which is recognized when a show occurs. Second, Live Nation includes language that seems to conflict with its disclosure about pushing 2020 ad costs into the future:

> *"However, all advertising costs incurred during the year and not previously recognized are expensed at the end of the year."*

Here's our estimate:

Live Nation accounts for refunds it issued for cancelled shows in accrued expenses. For the prior two years, accrued expenses were, on average, 11.75% of revenue. If we normalize the spike in accrued expenses as a percent of revenue in 2020 and subtract it from reported accrued expenses, we get a rough refund estimate of $674.8 million.

We are assuming that anyone receiving a refund initially purchases a ticket, in part, because the event was marketed to them. If we take the average advertising expense as a percent of concert revenue for the prior two years of 5.2% and multiply it by our refund estimate, we get $35.1 million.

Live Nation also includes $35 million in concerts that have been rescheduled after December 31, 2021 in long term liabilities, suggesting another $1.82 million in sunk but not yet recognized ad costs. **In total, we estimate Live Nation spent $36.92 million** advertising concerts that were cancelled in 2020 and will be recognized in 2021 and beyond. **This is approximately 7.7% of Live Nation's total ad spend in each of the prior two years**.

On one hand our estimate may be high, as you'll recall Live Nation lumps general and event-related ad costs together, meaning we've overstated ad costs as a percent of revenue used in our calculation. On the other hand, using only our estimate for refunds likely understates Live Nation's event-related ad expense as some customers elected to receive vouchers to future events rather than refunds.

The Winkler Group has contacted Live Nation for more information. Specifically, we requested the company provide us the ad expenses incurred in 2020 that will be recognized in the future. We'll update subscribers when we receive new information.

NEW RISK ALERT: (FLT)

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

New language in latest 10-K also hints federal lawsuit accusing firm of bilking customers out of hundreds of millions may be settled without penalty.

By Nick Winkler
March 17, 2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

New Calculation Inflates Fleetcor's Adjusted Net Income by $102 Million

Fleetcor Technologies, a payments and business spend company, overstated 2020 non-GAAP adjusted income by more than $100 million. Though it's commonplace to eliminate inconvenient items from net income, investors relying on the Fleetcor's non-GAAP calculation— especially for 2020 results— are getting a misleading picture of the company's financial performance.

Fleetcor would argue that it uses metrics like adjusted net income to eliminate the effect of items it does not consider indicative of core operating performance on a consistent basis. In its 2019 annual report, Fleetcor listed the items it strips out when calculating adjusted non-GAAP net income:

> *"(a) non-cash stock based compensation expense related to share based compensation awards, (b) amortization of deferred financing costs, discounts and intangible assets, amortization of the premium recognized on the purchase of receivables, and our proportionate share of amortization of intangible assets at our equity method investment, and (c) other non-recurring items, such as the impact of the Tax Act, impairment of investment, asset write-offs, restructuring costs, gains and related taxes due to disposition of assets and a business, loss on extinguishment of debt, legal settlements/litigation, and the unauthorized access impact."*

In its 2020 annual report, Fleetcor added two items it now eliminates from its adjusted net income calculation:

> *"a) non-cash stock based compensation expense related to share based compensation awards, (b) amortization of deferred financing costs, discounts and intangible assets, amortization of the premium recognized on the purchase of receivables, and our proportionate share of amortization of intangible assets at our equity method investment, and* ***(c) integration and deal related costs****, and (d) other non-recurring items,* ***including unusual credit losses occurring largely due to COVID-19****, the impact of discrete tax items, impairment charges, asset write-offs, restructuring costs, gains due to disposition of assets and a business, loss on extinguishment of debt, and legal settlements."*

Our analysis of Fleetcor's footnotes suggest the new items Fleetcor strips out inflated the company's adjusted net income by $102 million in 2020. In addition to the items it normally strips out, Fleetcor eliminated $12 million in integration and deal related costs, and $90 million in COVID-19 related receivables losses. These items alone, when added back, reduce Fleetcor's adjusted net income from $962 million to $860 million, or 10.6%. If we add back all of the items Fleetcor strips out, net income is reduced by $258 million, or 26.8% of adjusted net income.

Even those of you who believe Fleetcor is right to strip out the $90 million in unusual credit losses due to a once-in-a-century pandemic likely agree excluding the $12 million in integration and deal related costs is inappropriate. Fleetcor is a serial acquirer— it has bought or invested in 35 companies since 2000— and regularly touts its "expansion through acquisition" strategy. These costs are not unusual. They're recurring and part of Fleetcor's business model.

NEW RISK ALERT: (GOOGL)

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

New useful life estimate, according to our analysis, will lift 2021 EPS 5% higher than consensus estimates but not improve the quality of Alphabet's earnings.

Published 1/26/2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Google Stretches the Useful Life of Key Assets Over Several Additional Years

Alphabet, Google's parent company, will depreciate some of its key assets slower in 2021 than in the past. The company is changing its accounting estimate for the useful lives of its servers and network equipment:

- The estimated useful life of its servers will increase to **four years from three**
- The estimated useful life of certain network equipment to **five years from three**

The change will add approximately $2.1 billion to Alphabet's operating earnings for 2021, or $3.07 per diluted share though the impact may vary as the company adjusts its CapEx throughout the year.

Earnings Will Rise, Quality of Earnings Won't

Even without arguing whether Google's assets are truly lasting longer than originally estimated, it's clear the accounting change will positively impact the company's reported earnings. Our analysis reveals the timing of the change to be especially beneficial to reported earnings as Google happens to be spending more on servers— which depreciate slower due to the change— in 2021.

On the Q4 2020 earnings call Alphabet disclosed CapEx would rise significantly in 2021, with much of that increase coming from servers:

> *"Looking ahead, we expect a return to a more normalized pace of ground-up construction and fit-out of office facilities, which translates into **a sizable increase in CapEx in 2021**. **Servers will continue to be the largest driver of spend on technical infrastructure**."*

If we take Wall Street's consensus estimates— made prior to the accounting change announcement— we estimate Alphabet will report $68.52 per basic share, or 5% higher than the GAAP consensus forecast of $65.15 in 2021. Of particular interest to investors is whether Google grows CapEx faster than consensus, 16.8% in 2021. If so— and much of the spend is on servers and network equipment— free cash flow will be negatively impacted to a greater degree than reported earnings.

NEW RISK ALERT: (WH)

Wyndham's New Accounting Policy May Understate Goodwill Impairment

Latest 10-K reveals hotel chain's pandemic related impairment is below the lodging industry average.

Published February 16, 2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Wyndham Changes its Accounting Policy

Wyndham Hotel & Resorts, a global hotel franchisor with more than twenty brands, experienced a 37% decline in revenue in 2020. It lost $158 million after turning a $207 million profit in 2019. The travel industry was one of the hardest hit by the global pandemic. It's also one of the last to rebound.

Wyndham purchased La Quinta for $1.95 billion just weeks before the global pandemic prompted travel restrictions and lockdowns that torpedoed the lodging industry. The plunge in occupancy triggered impairment testing throughout the industry. Coincidentally, public companies were required to adopt an amended accounting rule related to how goodwill is tested for impairment in 2020.

It was no surprise then to see Wyndham adopt the new policy in its latest annual report. In its 2019 10-K, Wyndham disclosed it used a two-step process to test for goodwill impairment:

> *"This is done either by performing a qualitative assessment or **utilizing the two-step process**, with an impairment being recognized only where the fair value is less than carrying value."*

In its 2020 10-K, Wyndham notes that it now uses a one-step test:

> *"This is done either by performing a qualitative assessment or **utilizing the one-step impairment test**, with an impairment being recognized only where the fair value is less than carrying value."*

The new standard eliminates step two of the goodwill impairment test which companies say is costly and complex to comply with. Impairment is still the difference between a reporting unit's carrying value and its fair value— capped by the reporting unit's total goodwill— but no longer measures the fair value of each asset and liability of the reporting unit to quantify the impairment.

While some argue the change will increase the amount of impairment reported, others suggest that impairment resulting from the new test does not consider the true economic value of an entity's assets and liabilities since changes in those values are ignored.

Wyndham's Goodwill Impairment is Below the Industry Average

In the second quarter of 2020, Wyndham announced a $206 million impairment charge related to La Quinta. This contrasts slightly with Wyndham's 2020 annual report, which states the impairment was $205 million. Either way, Wyndham attributes much of the impairment to the use of a higher discount rate in its DCF analysis.

Industry data suggests Wyndham's discount rate may not have been high enough. The $206 million impairment is 14.8% of the $1.38 billion in goodwill Wyndham recorded in the La Quinta transaction. The average pandemic related hotel impairment is 20.2%, or 5.4% more than Wyndham calculates.

On October 1, 2020, Wyndham finished its annual impairment test and determined no additional impairment was necessary. The following month, data revealed that U.S. hotel occupancy had declined 304% from the prior year.

NEW RISK ALERT: (MTH)

Meritage Homes Recognizes Revenue From Insurance Policies Not Yet Renewed

New language in latest 10-K reveals home builder counts estimated future renewals as revenue.

Published February 17, 2021

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Meritage Homes Recognizes Revenue From Future Insurance Policy Renewals

As part of its financial services segment, Meritage Homes, a home builder targeting first time and move-up home buyers, offers title and escrow, mortgage, and insurance services. In the fourth quarter of 2019, Meritage began operating a wholly owned insurance broker that works with insurance companies nationwide to offer homeowners' insurance and other insurance products to its home buyers..

In its 2019 10-K, Meritage provided detail regarding its revenue recognition policy for its financial services segment:

> *"Our performance obligations for policy renewal commissions are considered satisfied upon issuance of the initial policy."*

In its 2020 10-K, Meritage includes new language that is more explicit:

> *"Revenue from financial services* ***includes estimated future insurance policy renewal commissions as our performance obligations are satisfied upon issuance of the initial policy with a third party broker****."*

It's unclear why Meritage assumes homeowners are certain to renew with the same insurer— in perpetuity or at least for the duration of their mortgage— since, on average, 16% of homeowners switch insurance companies annually. Meritage says contract assets for estimated future renewal commissions are not material.

In 2020, Meritage's financial services segment— which includes estimated future policy renewals— accounted for 3% of the company's pre-tax net income. In 2019, the segment accounted for 6.8% and in 2018 it accounted for 8.5%.

NEW RISK ALERT: (CREE)

Cree Understates Inventory and Payables, Corrects Tax Calculation Error

New language in latest 10-Q highlights multiple new key metric calculation methods.

Published February 18, 2021

This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Cree Not Counting Certain Inventories & Payables in DSI and DPO

Cree is selling its LED business to focus exclusively on semiconductor products for power and radio-frequency (RF) applications. Cree's future depends, in part, on the semiconductor industry's adoption of silicon carbide. As a result, Cree is building a silicon carbide fabrication facility in New York.

Cree's Days Payable Outstanding (DPO) were flat as of December 29, 2020 compared to six months prior, but only because the company is no longer counting certain payables. In its fourth quarter 2020 10-Q, Cree disclosed what it does not count in DPO:

> *"Due to the significant amount of capital expenditures associated with our future silicon carbide fabrication facility in New York, **we exclude accounts payable related to capital expenditures in connection with the facility**."*

Similarly, Days of Supply Inventory (DSI) fell in the six months ending December 29, 2020. In the latest 10-Q, Cree disclosed the type of inventory it no longer counts when calculating DSI:

> *"..(**excluding inventory** related to a future Wafer Supply and Fabrication Services Agreement to be entered into in connection with the LED Business Divestiture (the "Wafer Supply Agreement")..."*

The Wafer Supply and Fabrication Agreement is part of the LED segment divestiture. Cree will supply the acquirer with silicon carbide materials and fabrication services for four years.

Investors wishing for a more accurate picture of Cree's working capital in the future will have to add back the inventory and payables Cree excludes.

Cree Corrects Million Dollar Tax Calculation Error

In the latest 10-Q, Cree revised income tax expense for the three and six months ended December 29, 2019 to correct its income tax provision calculation for the second quarter of fiscal 2020:

> *"The Company increased income tax expense for the three and six months ended December 29, 2019, resulting in a net increase to net loss of $1.5 million in each period."*

The Company also revised the unaudited statements of operations for the three months ended March 29, 2020 in the unaudited interim consolidated financial statements to be filed in the quarterly report in the 10-Q for the corresponding period in fiscal 2021 to decrease income tax expense by $1.5 million for the three months ended March 29, 2020. The result, according to Cree is:

> *"...a net decrease to net loss of $1.5 million for the three months ended March 29, 2020."*

Cree says no additional revisions will be necessary to the unaudited statement of operations for the nine months ended March 29, 2020. Though Cree considers the errors immaterial, we flag them as they coincide with new calculation methods for DPO and DSI as items of interest— or possibly patterns— to watch in future quarters.

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NETFLIX
Six weeks before The Wall Street Journal, Financial Times, and Bloomberg broke news of 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
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 no longer featuring self-driving technology as prominently in its latest annual report.

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

What they're saying

Here's a sample of the unsolicited feedback we receive:

> ***"I see a lot of value in the product. Very unique."***
>
> ***"I love getting these alerts. They're fascinating. Thank you!"***
>
> ***"It's a useful tool. No one has time to read all the footnotes so surfacing meaningful information is valuable."***
>
> ***"This is a great research service you have put together. I really do look forward to opening each one even when they fall outside my scope of investable companies."***

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