Earnings quality

Financial Statement Analysis

1 A story: two shops, one profit

- Shop 1: coffee sold daily, paid on the spot
- Shop 2: van sale, unpaid sales, delayed bills
- Same reported profit, very different shops
- Earnings quality = the character of profit

IN THE LESSON

- Imagine two shops that each report a profit of one hundred thousand this year.
- The first sells coffee every day, customers pay on the spot, and the profit is the same as last year.
- The second had a quiet year, but its owner sold the delivery van for a big gain, counted sales to a friend who has not paid yet, and delayed some repair bills.
- Same profit on the page.
- Very different shops.
- Earnings quality is the idea that profit has a character, not just a size.
- High quality profit is real, it repeats, and it turns into cash.
- Low quality profit is flattered by one-offs, timing and guesswork.
- Your job as an analyst is to tell them apart.

2 Three tests of good earnings

- 1. Recurring: will it happen again?
- 2. Backed by cash: does profit turn into cash?
- 3. Not propped up by estimates and judgement
- Fail any test and look closer

IN THE LESSON

- So what does good look like?
- Three tests.
- First, are the earnings recurring?
- Will the same activities produce a similar profit next year?
- Profit from selling a building will not.
- Second, are they backed by cash?
- Over time, profit is simply cash with the timing adjusted, so the two should travel together.
- Third, are they free from propping up by estimates?
- Many profit numbers rest on judgements: how long machines last, how many customers will fail to pay, how much to set aside for warranties.
- Change an estimate a little and profit moves, though no cash has.
- A profit that passes all three tests is higher quality.
- One that fails any of them deserves a closer look.

3 The cash gap, year by year

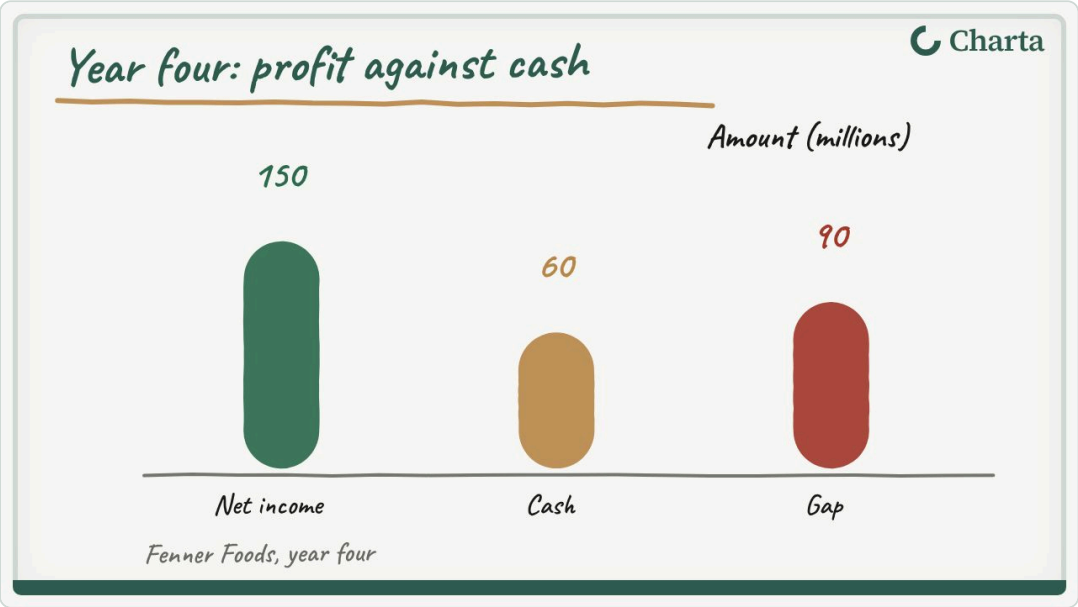
Fenner Foods: net income less operating cash flow

Year	Profit minus cash
Year 1	−5
Year 2	+20
Year 3	+52
Year 4	+90

IN THE LESSON

- Let us watch the first warning sign appear.
- Here is a made-up company, Fenner Foods, over four years.
- The table shows net income minus the cash the operations produced.
- Net income is the profit after every cost.
- Operating cash flow is the cash the daily business actually generated.
- In year one, profit is a little below cash, which is perfectly healthy.
- In year two, profit is twenty above cash.
- In year three, fifty two.
- In year four, ninety.
- A gap this size is accruals, meaning profit recorded before the cash arrives.
- One year of gap can be innocent, because a growing business ties up money in stock and customers.
- A gap that rises every year is a pattern.

4 Year four: profit against cash



IN THE LESSON

- Now the picture for year four.
- The vertical axis is the amount, in millions.
- The first bar is net income, one hundred and fifty.
- The second bar is operating cash flow, only sixty.
- The third bar is the gap between them, ninety.
- Look at how large it is.
- More than half of the reported profit is not yet in the bank.
- That ninety has to be sitting somewhere on the balance sheet, perhaps in customers who owe money, in unsold stock, or in costs that were stored away rather than expensed.
- Each of those is an estimate.
- It will either turn into cash later, or be written off.
- The question to ask is which one, and the answer decides how good the profit really is.

5 Warning signs in the results

- Growth driven by non-recurring gains
- Large, rising gap: net income vs operating cash
- Restructuring called a one-off, year after year
- Always just meeting or beating the forecast

IN THE LESSON

- Let us collect the main warning signs.
- One: profit growth that comes from non-recurring gains, such as selling an asset or a tax credit, rather than from selling more.
- Two: a large and rising gap between net income and operating cash flow, as we just saw.
- Three: restructuring charges that are called one-offs but turn up again and again.
- If it happens every year, it is a cost of doing business.
- Four: a pattern of just meeting or narrowly beating analysts' forecasts, quarter after quarter.
- Real businesses are bumpy.
- A record that lands a penny above the forecast every time suggests that someone is steering the number with estimates.

6 Serious signals and aggressive accounting

- Restatements, enforcement actions, auditor changes
- Bill and hold: sale booked, goods still in store
- Gross rather than net revenue inflates sales
- Costs capitalised so they miss this year's profit

IN THE LESSON

- Some signs are more serious.
- A restatement means the company had to correct figures it already published.
- An enforcement action means a regulator has taken action over the accounts.
- A change of auditor, especially after a disagreement, is a red flag.
- Then there are aggressive choices.
- Bill and hold means the company records a sale but keeps the goods in its own warehouse.
- Reporting revenue gross rather than net means a company that is only an agent shows the whole sale as revenue, instead of just its commission, which inflates sales.
- And capitalising costs means recording a cost as an asset, so it skips the income statement now.
- Each pushes profit upwards today at the expense of tomorrow.

7 Example 1: finding Fenner's core earnings

Year 5: net income 152 incl. a gain of 20; restructuring of 15 added back

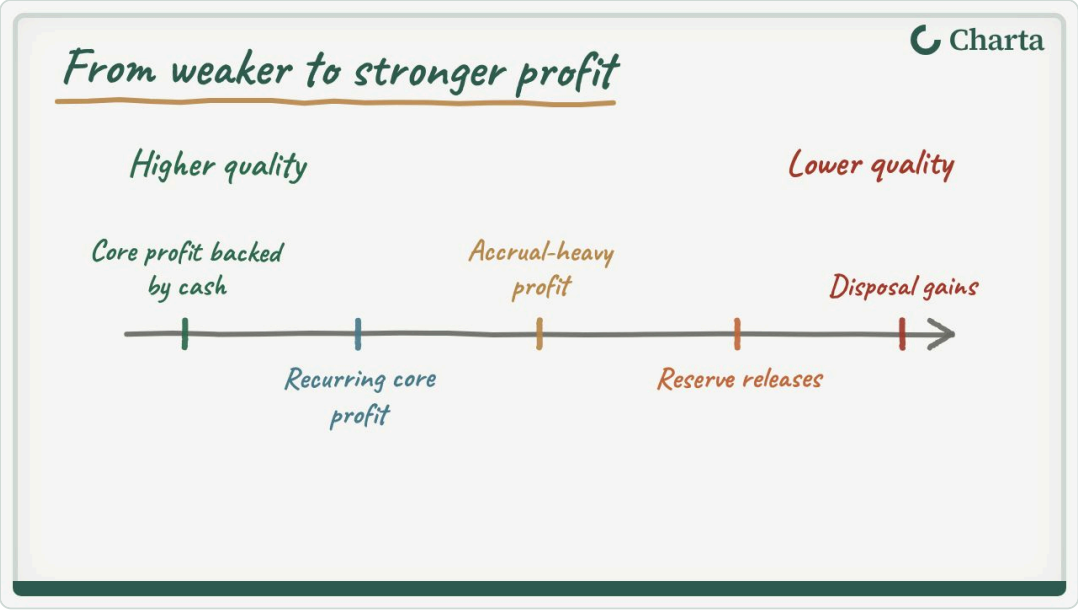
Management's figure	152 + 15	**167**
Restructuring	four years running: stays in	**recurring**
Gain on division	will not repeat: out	**−20**
Core earnings	152 − 20	**132**
Gap to management	167 − 132 = 21% of 167	**35**

The recurring charge stays in; the one-off gain comes out

IN THE LESSON

- Example one, in year five.
- Fenner reports net income of one hundred and fifty two.
- That includes a gain of twenty from selling a division.
- Management also took a restructuring charge of fifteen, and adds it back to show adjusted profit of one hundred and sixty seven.
- Restructuring charges have appeared in each of the last four years.
- Step one, management's figure is one hundred and fifty two plus fifteen, which is one hundred and sixty seven.
- Step two, the restructuring happens every year, so it is recurring and stays in.
- Step three, the gain on the division will not repeat, so it comes out.
- Core earnings are one hundred and fifty two minus twenty, which is one hundred and thirty two.
- The gap to management's figure is thirty five, about twenty one per cent of it.

8 From weaker to stronger profit



IN THE LESSON

- Here is a way to rank profit by quality.
- The line runs from higher quality on the left to lower quality on the right.
- At the far left, the best kind: core profit that is also backed by cash.
- Next, recurring core profit from the main activities.
- In the middle is accrual-heavy profit, which depends on estimates and timing.
- Further right are reserve releases, where a company simply sets less aside than before and profit rises.
- And at the far right sit disposal gains: they happen once and have nothing to do with the business.
- When you read a set of accounts, try placing each slice of profit on this line.
- The more sits to the left, the more you can rely on it.

9 The trap: smooth is not safe

- Smooth profit can come from managed reserves
- Good year: stash extra in the reserve
- Poor year: release some back into profit
- Smoothness is a prompt to check the cash

IN THE LESSON

- Here is the trap on this outcome.
- Many learners reason that a company whose profit rises gently every year, never a bump, must be high quality.
- It feels stable.
- But real businesses are lumpy.
- Sales wobble, costs surprise.
- A perfectly smooth line can mean management is using estimates to even things out.
- In a good year they set aside extra for bad debts and warranties.
- In a poor year they release some of it back into profit.
- The reserve acts like a cookie jar.
- Smoothing is itself a form of managing earnings.
- So smooth earnings are not a reason to relax.
- They are a reason to ask where the reserves are going and whether the cash tells the same calm story.

10 Sustainable means likely to continue

- Sustainable = likely to continue
- Kiosk: steady. Heatwave sales: one-off
- Value is a bet on future profit
- Measure persistence with a regression

IN THE LESSON

- Now to the second idea, sustainable earnings, also called persistent earnings.
- Picture two ice cream sellers.
- One has a kiosk by a station, with steady customers all year.
- The other had a freak heatwave and sold three times the usual.
- Both beat last year.
- Which result would you expect to see again?
- The kiosk.
- The heatwave is a gift of the weather.
- Sustainable earnings are the ones likely to continue into the future, and that matters because a share price is a bet on future profit.
- If you pay a high multiple for earnings that will not last, you lose.
- The aim is to measure persistence with a number, not just a feeling.
- The tool for that is a simple regression.

11 The persistence regression

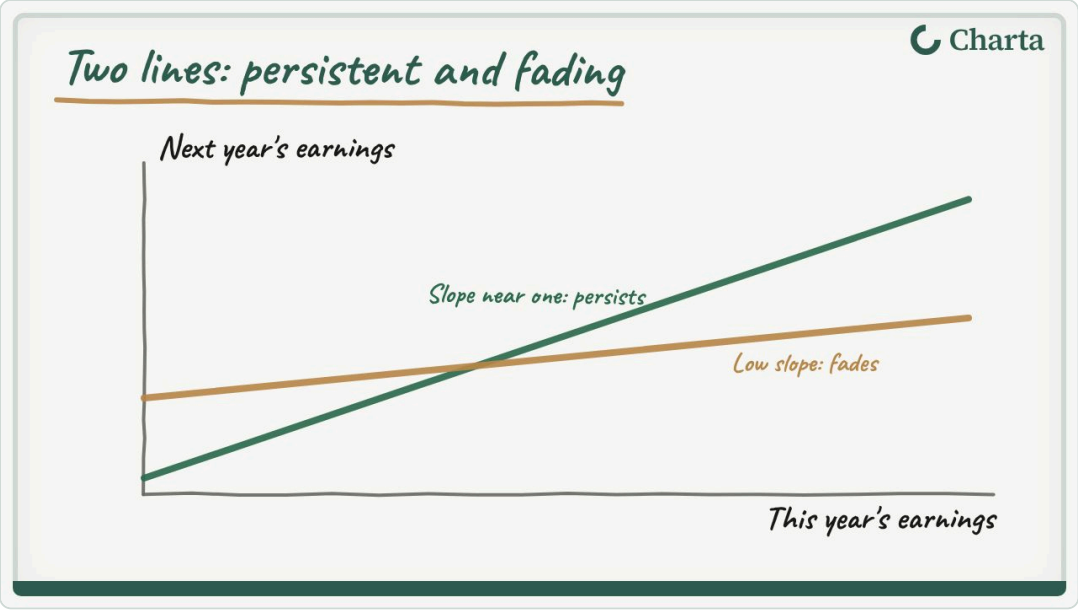
Next year's earnings = α + β × This year's earnings

Next year's earnings	What we want to predict
This year's earnings	What we know today
α: intercept	Starting level of the line
β: slope	Persistence: near 1 is strong

IN THE LESSON

- Here is the regression.
- Next year's earnings equals alpha, plus beta times this year's earnings.
- Alpha is the intercept, the level where the line starts.
- Beta is the slope, and it is the part we care about.
- It tells you how much of each extra dollar of profit this year turns up again next year.
- A beta close to one means earnings are highly persistent: a strong year predicts another strong year almost one for one.
- A beta close to zero means earnings fade quickly, and this year's result tells you little about next year.
- In practice the analyst fits this line across many companies or many years, then reads the slope.

12 Two lines: persistent and fading



IN THE LESSON

- Now the picture.
- The horizontal axis is this year's earnings.
- The vertical axis is next year's earnings.
- Pick a level on the horizontal axis, go up to a line, and read across to what we expect next year.
- The steep line has a slope near one.
- A strong year this year predicts a strong year next year, almost one for one.
- That is persistent earnings.
- The shallow line has a low slope.
- Whatever happened this year, next year is pulled towards the middle.
- A record year and a poor year both predict something quite ordinary.
- The flatter the line, the less each dollar of today's profit is worth, so the lower the multiple you should pay for it.

13 Example 2: two firms, same record year

Persistent: α = 5, β = 0.9. Fading: α = 60, β = 0.4

Persistent, earnings 100	5 + 0.9 × 100	**95**
Persistent, earnings 150	5 + 0.9 × 150	**140**
Fading, earnings 100	60 + 0.4 × 100	**100**
Fading, earnings 150	60 + 0.4 × 150	**120**
Extra 50 carries forward	0.9 × 50 vs 0.4 × 50	**45 vs 20**

IN THE LESSON

- Example two.
- An analyst has fitted the line for two kinds of firm.
- For a firm with persistent earnings, alpha is five and beta is zero point nine.
- For a firm with fading earnings, alpha is sixty and beta is zero point four.
- First, a normal year, this year's earnings of one hundred.
- The persistent firm is expected to earn five plus zero point nine times one hundred, which is ninety five.
- The fading firm, sixty plus zero point four times one hundred, is one hundred.
- Now a better year, earnings of one hundred and fifty.
- The persistent firm gives one hundred and forty.
- The fading firm, only one hundred and twenty.
- A jump of fifty carries forward as forty five for the first, but just twenty for the second.

14 Splitting earnings into cash and accruals

Next year's earnings = α + β_1 × Cash flow + β_2 × Accruals

Next year's earnings	What we want to predict
Cash component	Backed by money received
Accrual component	Estimates and timing
β_1: cash slope	Usually the larger
β_2: accrual slope	Usually the smaller

IN THE LESSON

- The next step is to split earnings into two parts.
- Earnings equal cash flow plus accruals.
- Cash flow is the part backed by money received.
- Accruals are everything else, the estimates and timing.
- We can then regress next year's earnings on both parts.
- Each gets its own slope, beta one for the cash part and beta two for the accrual part.
- The key finding from research is that beta one is larger than beta two.
- Cash tends to persist.
- Accruals tend to reverse, because a receivable is either collected or written off, and a cost that was deferred must be absorbed later.
- So a dollar of cash profit is worth more next year than a dollar of accrual profit.

15 Example 3: Company A against Company B

α = 0, β_1 = 0.9 (cash), β_2 = 0.5 (accruals). Both earn 100

A: cash 90, accruals 10	0.9 × 90 + 0.5 × 10	**86**
B: cash 40, accruals 60	0.9 × 40 + 0.5 × 60	**66**
B against A	66 ÷ 86 − 1	**−23.3%**

Same profit this year; B is mostly accruals

IN THE LESSON

- Example three.
- Use alpha of zero, beta one of zero point nine on cash, and beta two of zero point five on accruals.
- These are illustrative numbers.
- Company A earns one hundred, made of ninety in cash and ten in accruals.
- Company B also earns one hundred, but only forty in cash and sixty in accruals.
- Company A next year: zero point nine times ninety, plus zero point five times ten, gives eighty one plus five, which is eighty six.
- Company B: zero point nine times forty plus zero point five times sixty gives thirty six plus thirty, which is sixty six.
- Sixty six divided by eighty six, minus one, is about minus twenty three per cent.
- Same reported profit today, nearly a quarter less expected next year.

16 Example 4: paying the right multiple

Market pays 15 times earnings for Company A

Same multiple, both	15 × 100	**1,500**
B scaled by persistence	1,500 × 66 ÷ 86	**1,151**
Overpayment	1,500 − 1,151	**349**
As a share of the price	349 ÷ 1,500	**23.3%**

Do not value every component of profit at the same multiple

IN THE LESSON

- Example four, the lesson for valuation.
- Suppose the market pays fifteen times for Company A's earnings.
- If you apply the same multiple to Company B because it reports the same one hundred, you would value both at fifteen hundred.
- But Company B's earnings are only about three quarters as persistent as A's, in the sense of what we expect next year.
- Scale it.
- Fifteen hundred times sixty six over eighty six gives about eleven hundred and fifty one.
- By treating the two the same, you would overpay by about three hundred and forty nine, which is again about twenty three per cent of the price.
- So earnings made largely of accruals deserve a lower multiple.
- And gains on disposals deserve a lower one still than recurring operating profit.

17 Four mistakes to avoid

- 1. Smooth profit is not proof of quality
- 2. One multiple for every slice of profit
- 3. Extrapolating a record year built on accruals
- 4. Trusting management's adjusted profit

IN THE LESSON

- Time to pause on the mistakes that cost marks in this topic.
- One: treating a smooth earnings record as high quality.
- Smoothing can come from managed reserves.
- Two: valuing every component of profit at the same multiple.
- Recurring cash backed profit and a one-off disposal gain are not the same thing.
- Three: building a forecast on a record year that was driven by accruals.
- Accruals reverse, so the record is the part least likely to repeat.
- Four: accepting profit as management defines it.
- Adjusted figures often leave out costs that recur, such as restructuring, and then overstate what the core business earns.
- Keep these four in mind as we move on to mean reversion and then to the full judgement.

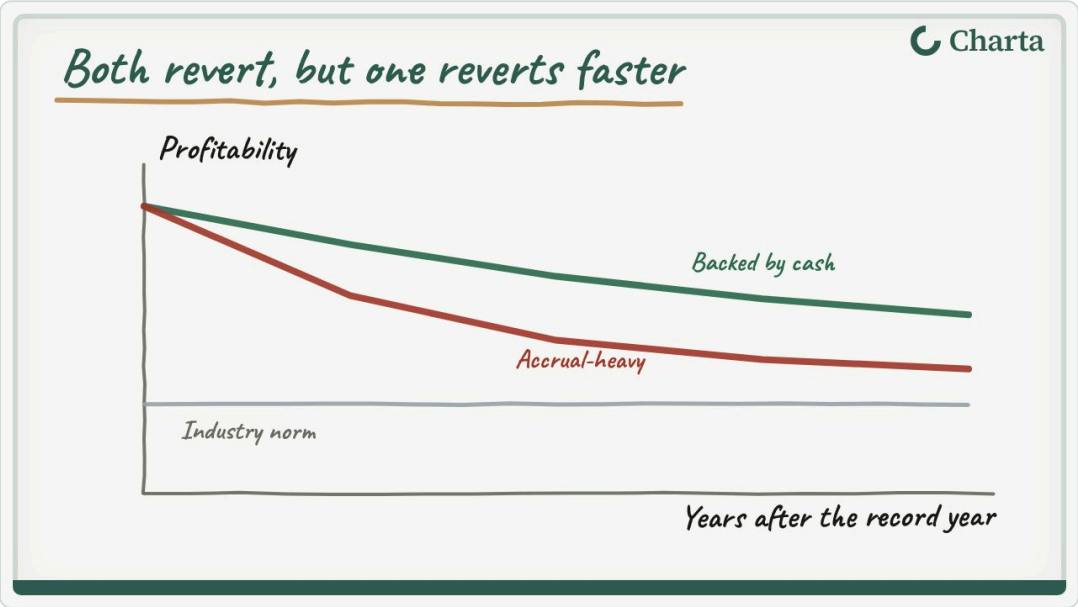
18 Why extreme profits drift back

- Very high profit attracts rivals and competition
- Very low profit leads to fixes, closures, exits
- Result: earnings drift back towards the norm
- Do not extrapolate extreme earnings

IN THE LESSON

- Now our third idea, mean reversion.
- Think of a restaurant that is suddenly the hottest in town and earns huge profits.
- What happens next?
- Rivals open nearby, copy the menu, and bid for the same chefs.
- The extra profit gets competed away.
- Now think of a restaurant losing money.
- The owner changes the menu, cuts costs, or closes.
- The poor results improve or disappear.
- In both directions the result is pulled back towards the norm.
- Mean reversion means that earnings far above or far below the typical level tend to move back towards it.
- For the analyst the message is plain: do not extrapolate extreme earnings.
- A record is more likely to be followed by a smaller number than a bigger one.

19 Both revert, but one reverts faster



IN THE LESSON

- Here is the picture.
- The horizontal axis is the years after a record year.
- The vertical axis is profitability.
- Look first at the flat grey line near the bottom: the industry norm.
- Now two companies start from the same record height.
- Both fall towards the norm, because competition works on both.
- The upper curve is the company whose record was backed by cash.
- It falls more gently.
- The lower curve is the company whose record was built on accruals.
- It falls faster and further, because its accruals are reversing at the same time.
- If you screened on this year's profitability alone, you could not tell them apart.
- Their make-up is what separates them, and that is why composition matters.

20 How accruals change the speed

- Accrual = profit booked before the cash
- Receivables get collected or written off
- Capitalised costs are expensed later
- More accruals in profit means faster reversion

IN THE LESSON

- Why do accruals speed up the fall?
- Remember what an accrual is: profit recorded now, before the cash.
- A sale on credit is booked today, but the customer still has to pay.
- Either they pay, and the receivable disappears, adding no further profit, or they do not, and it is written off, hurting profit.
- A cost put on the balance sheet as an asset is the same: it will be spread out as an expense later.
- And many accruals are estimates, which management can adjust, but not forever.
- A reserve cut helps one year, then it is gone.
- So earnings with a big accrual part revert faster than earnings backed by cash.
- To spot them, analysts measure accruals as a ratio, and there are two standard versions.

21 The balance sheet accrual ratio

Balance sheet accrual ratio = (Net operating assets end − start) ÷ average net operating assets

Change in net operating assets	End minus start
Average net operating assets	(Start + end) ÷ 2
Balance sheet accrual ratio	Higher: less persistent

IN THE LESSON

- The first ratio uses the balance sheet.
- It asks how much the operating side of the business grew, compared with its average size.
- First, net operating assets: operating assets such as receivables, stock and machinery, minus operating liabilities such as payables.
- Cash, investments and debt are left out, because they are financing.
- If net operating assets rise a lot, the business has swelled with items that have not yet turned into cash.
- The ratio equals the change in net operating assets, end minus start, divided by the average of the start and end values.
- A higher ratio suggests that more of the profit is accrual, and so that earnings are less persistent.

22 The cash flow accrual ratio

Cash flow accrual ratio = (Net income − operating cash flow − investing cash flow) ÷ average net operating assets

Net income	Reported profit
Operating cash flow	Cash from daily business
Investing cash flow	Negative if investing
Average net operating assets	Same denominator
Cash flow accrual ratio	Higher: less persistent

IN THE LESSON

- The second ratio uses the cash flow statement.
- Take net income.
- Subtract the operating cash flow, which is the cash the business generated.
- Then also subtract investing cash flow, which is a negative number when the company spends on equipment and the like, so subtracting it adds the spending back.
- What is left is the part of profit not matched by cash from operating and investing activities.
- Divide it by the same average net operating assets.
- The two ratios look at accruals from different statements, so they land close together but not exactly.
- Again, the higher the ratio, the lower the expected persistence.

23 Example 5: Calder Plastics, a record year

Net operating assets 800 to 1,000; net income 150; CFO 60; CFI −120

Average net operating assets	(800 + 1,000) ÷ 2	**900**
Balance sheet ratio	(1,000 − 800) ÷ 900	**22.2%**
Cash flow ratio	(150 − 60 + 120) ÷ 900	**23.3%**
Peer, both ratios	comparable company	**3%**

About seven times the peer: expect this record to fade

IN THE LESSON

- Example five.
- Calder Plastics has just reported a record net income of one hundred and fifty.
- Net operating assets rose from eight hundred to one thousand.
- Operating cash flow was sixty, investing cash flow minus one hundred and twenty.
- A comparable peer has accrual ratios of three per cent.
- Step one, the average net operating assets are eight hundred plus a thousand, over two, which is nine hundred.
- Step two, the balance sheet ratio is two hundred over nine hundred, which is twenty two point two per cent.
- Step three, the cash flow ratio: one hundred and fifty minus sixty plus one hundred and twenty is two hundred and ten, over nine hundred, which is twenty three point three per cent.
- Both are about seven times the peer's three per cent.

24 Example 6: forecasting with reversion

Record 150, norm 90, so the excess is 60. Illustrative speeds

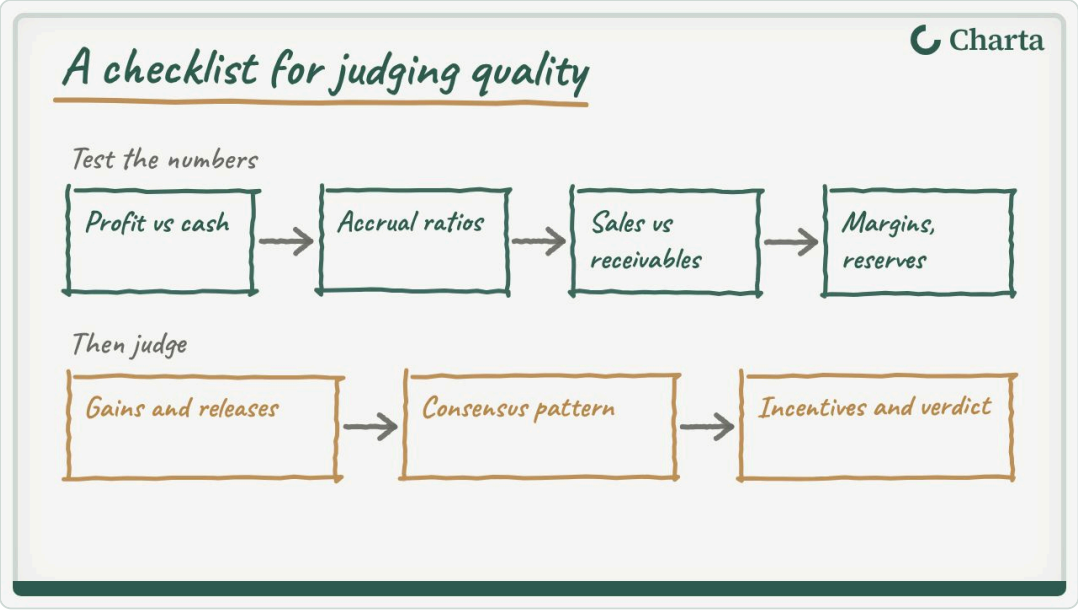
Excess over the norm	150 − 90	**60**
Cash backed: keeps 60%	90 + 0.6 × 60	**126**
Accrual heavy: keeps 30%	90 + 0.3 × 60	**108**
Overshoot if extrapolated	150 − 108	**42**

Calder is accrual heavy, so 108 is the better forecast

IN THE LESSON

- Example six: put reversion into a forecast.
- Calder's record net income is one hundred and fifty, and the normal level for a company like it is ninety.
- So the excess is sixty.
- Say a cash backed record keeps sixty per cent of its excess next year, while an accrual heavy record keeps only thirty per cent.
- These speeds are illustrative.
- For the cash backed case, next year is ninety plus zero point six times sixty, which is one hundred and twenty six.
- For an accrual heavy record like Calder's, it is ninety plus zero point three times sixty, which is one hundred and eight.
- Extrapolating the record at one hundred and fifty would have overshot by forty two.
- That is the trap, building a forecast on a record year driven by accruals.

25 A checklist for judging quality



IN THE LESSON

- Now the final skill, judging earnings quality.
- Think of a doctor who does not trust one test but runs a series.
- Here are the steps in order.
- First, test profit against cash, through the gap and the accrual ratios on both bases.
- Second, track those ratios over time, since a jump matters more than a level.
- Third, compare revenue growth with receivables and deferred revenue.
- Then look at margins: did gross margin rise because of lower reserves or capitalised costs?
- Next, check how much profit rests on gains or reserve releases, and how results compare with consensus.
- Finally, tie it all to management's incentives, and then adjust to core earnings and reach a verdict.

26 Example 7: Ashby Tools, the accrual ratios

Net income 150; CFO 60; CFI −90; net operating assets 800 to 1,000

Balance sheet ratio	(1,000 − 800) ÷ 900	**22.2%**
Last year	same ratio	**4%**
Cash flow ratio	(150 − 60 + 90) ÷ 900	**20.0%**
Reading	two measures agree	**jumped**

Profit well ahead of cash: accruals are doing the work

IN THE LESSON

- Example seven, our full case.
- Ashby Tools reports net income of one hundred and fifty, operating cash flow of sixty, and investing cash flow of minus ninety.
- Net operating assets rose from eight hundred to a thousand.
- Last year its balance sheet accrual ratio was four per cent.
- The average is nine hundred.
- The balance sheet ratio is two hundred over nine hundred, which is twenty two point two per cent, up from four per cent last year.
- The cash flow ratio is one hundred and fifty minus sixty plus ninety, which is one hundred and eighty, over nine hundred, which is twenty point zero per cent.
- Two separate measures agree, and both have jumped.
- Profit is running well ahead of cash, so the accruals are doing the work.

27 Example 8: where the accruals sit

Ashby Tools: revenue 1,000 to 1,080; receivables 200 to 260

Revenue growth	1,080 ÷ 1,000 − 1	**+8%**
Receivables growth	260 ÷ 200 − 1	**+30%**
Days sales outstanding, last year	200 ÷ 1,000 × 365	**73.0**
Days sales outstanding, now	260 ÷ 1,080 × 365	**87.9**

Sales booked, cash not collected: about 15 days slower

IN THE LESSON

- Example eight asks where the accruals are hiding.
- Ashby's revenue grew eight per cent, from one thousand to one thousand and eighty.
- But its receivables, the money customers owe, grew thirty per cent, from two hundred to two hundred and sixty.
- Receivables grew almost four times as fast as sales.
- Turn that into days sales outstanding, receivables over revenue times three hundred and sixty five.
- Last year it was seventy three days.
- This year it is about eighty eight.
- Customers are taking nearly fifteen days longer to pay, or sales are being booked earlier, or both.
- Either way, profit has been recorded that the cash has not yet confirmed.
- Now the question moves from what happened to who benefits.

28 Consensus, adjusted profit and incentives

- Tiny beats of consensus, again and again
- Adjusted profit may omit recurring costs
- Bonus, covenant or share sale: motive
- Incentives show where to look hardest

IN THE LESSON

- Two more checks.
- First, compare results with consensus, the average analyst forecast.
- Occasionally beating it is normal.
- But beating it by a tiny amount, again and again, can indicate management of estimates, since real results are noisy.
- Second, look at the definition of profit.
- Management often presents adjusted or non G A A P figures, such as adjusted E B I T D A, that leave out costs.
- If the excluded costs recur, as restructuring did at Fenner, the figure overstates core earnings.
- Finally, ask who gains.
- If a bonus, a loan covenant or a planned share sale depends on this year's profit, management has a motive to push it up.
- Incentives do not prove wrongdoing, but they tell you where to look hardest.

29 Recap

- Quality: recurring, backed by cash, not estimates
- Persistence: slope near one; cash beats accruals
- Extremes revert; accruals make it faster
- Judge: ratios, receivables, core earnings, incentives

IN THE LESSON

- Let us recap.
- Earnings quality asks whether profit is recurring, backed by cash, and free from propping up by estimates.
- Warning signs are one-off gains, a widening gap between profit and cash, repeated restructuring, constant narrow beats, restatements and aggressive accounting.
- Sustainable earnings can be measured with a regression of next year's earnings on this year's, where a slope near one means strong persistence, and splitting into cash and accruals shows that cash persists more.
- Extreme earnings revert towards the norm, faster when accruals are large, and the two accrual ratios flag that.
- To judge quality, test profit against cash, track the ratios, check receivables, strip out one-offs, mind incentives, and use core earnings.

30 Try three quick questions

1. NOA rise from 500 to 700. Balance sheet accrual ratio?
   Answer: 200 ÷ 600 = 33.3%
2. $E_1 = 10 + 0.5 \times E_0$ and $E_0 = 80$. Forecast?
   Answer: 10 + 40 = 50; only half persists.
3. Restructuring in each of five years, added back by management. Treatment?
   Answer: Recurring: keep it in core earnings.

IN THE LESSON

- Time for three quick questions.
- Question one: net operating assets rise from five hundred to seven hundred.
- What is the balance sheet accrual ratio?
- Answer: the change is two hundred, the average is six hundred, and two hundred over six hundred is thirty three point three per cent.
- Question two: the fitted line is next year's earnings equals ten plus zero point five times this year's, and this year's earnings are eighty.
- What is the forecast?
- Answer: ten plus forty is fifty, and the slope of one half says earnings are only half persistent.
- Question three: restructuring has been charged in each of five years, and management adds it back.
- How should the analyst treat it?
- Answer: it is recurring, so leave it in core earnings.