Valens Research – UAFRS vs As-Reported Monthly Highlights | February 28, 2021

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No industry is free from the inconsistent rules of GAAP accounting that create extensive distortions from economic reality. In this issue, we highlight a chemicals company, a payroll servicer, and a diversified industrial conglomerate. Everything from net earnings to total assets is calculated in ways that seem almost arbitrary under Generally Accepted Accounting Principles.

Quaker Chemicals' R&D expenses are half of net income. That means that small changes in their R&D will have a massive impact on earnings. How then does one judge the earning power of a firm if it can be either managed upward or unfairly punished simply by management's discretion over how much to invest this year?
Economic profit, as represented by the difference between return on assets and a firm's cost of capital, is one of the most important measures in an investor's toolkit. Yet, when calculated under GAAP, CBIZ would look like its economic profit is significantly negative, with return on assets far below any measure of its cost of capital. In reality, UAFRS-based metrics show that the firm is a massive generator of economic profit. Clearly the stock market agrees with the Uniform-calculated numbers under UAFRS.

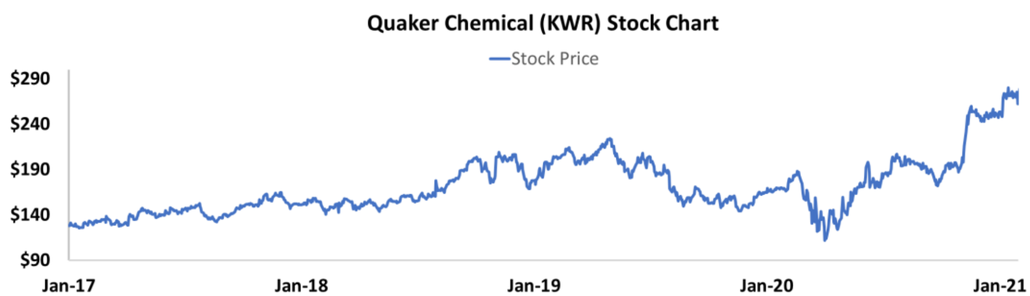
Roper Technologies' acquisitive nature has led to a massive level of goodwill and intangibles that pull down the firm's calculation of earning power, return on assets. It is important to note if the underlying business is a good one or a bad one, which is difficult to discern under existing GAAP methods for accounting for mergers and acquisitions. Roper may have spent quite a bit to assemble the business they had today. However, that business is a phenomenal earnings generator.

See below for a detailed look into just how much UAFRS reveals the true profitability of a business, one which the stock market consistently agrees with.

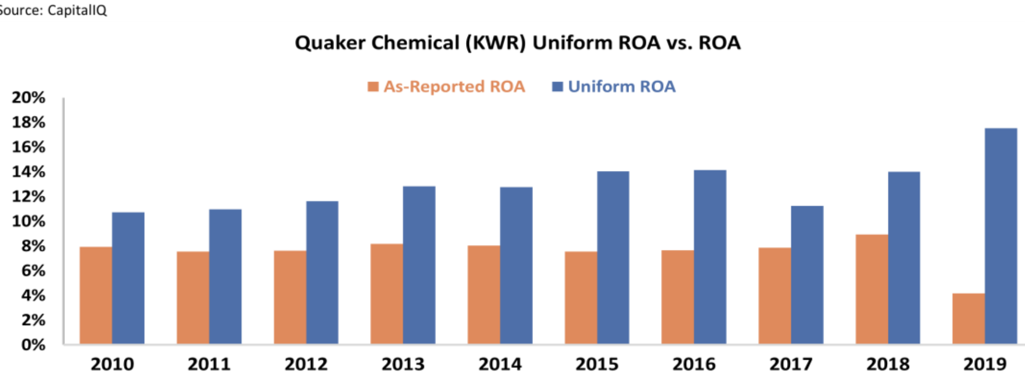
KWR – UAFRS shows how as-reported metrics distort true profitability

Since 2017, KWR shares have increased significantly, rising from approximately $130/share to almost $300/share, an over 130% price appreciation. That said, according to the market, KWR appears to be a firm that has seen a drop-off in profitability, and not a company that had seen notable fundamental improvements.

That said, using Uniform Accounting, we can identify distortions such as a firm's expenses being overstated due to the treatment of R&D expenses, as is the case with KWR, which substantially suppresses profitability metrics. Due to its material R&D investments, as-reported metrics make the firm appear to have stable, but recently declining profitability, ranging below corporate averages. Meanwhile, UAFRS-adjusted metrics paint a significantly different picture of KWR, showing a firm that had seen its R&D investments lead to more robust Uniform ROA in recent years, improving from corporate average 11% levels in 2017 to a peak of 18% in 2019, justifying stock appreciation.



Source: CapitalIQ



Sources: UAFRS, CaptialIQ

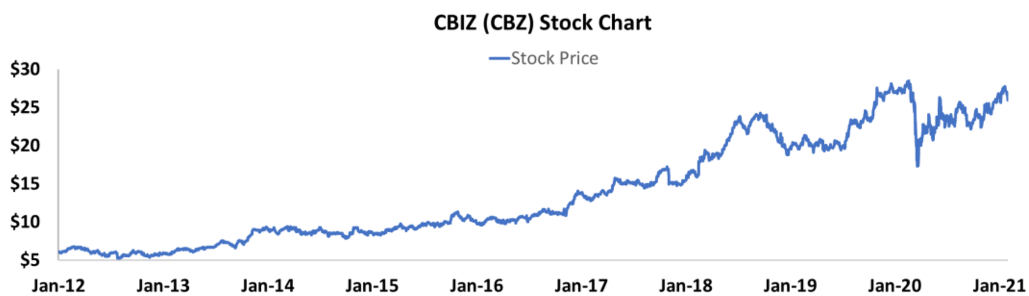
KWR - Quaker Chemical Corporation	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
R&D expense	15.7	18.8	20.0	21.6	22.1	22.1	22.5	23.9	24.5	32.1
Capitalized R&D investment	106.2	111.5	119.0	128.8	136.5	140.7	148.0	156.6	164.1	178.2
Uniform earnings	44.7	50.5	56.8	65.0	69.6	75.7	76.9	65.3	83.9	152.4
Net income	16.2	32.1	45.9	47.4	56.3	56.5	51.2	61.4	20.3	59.5
% Variance	-63.7%	-36.4%	-19.2%	-27.0%	-19.0%	-25.3%	-33.4%	-5.9%	-75.8%	-61.0%
Uniform net assets	416.4	460.9	489.4	506.3	546.0	538.8	544.2	581.4	599.4	869.7
Total assets	395.3	449.4	511.2	536.6	584.1	665.5	680.7	692.0	722.1	709.7
% Variance	-5.1%	-2.5%	4.4%	6.0%	7.0%	23.5%	25.1%	19.0%	20.5%	-18.4%
Uniform ROA	10.7%	11.0%	11.6%	12.8%	12.7%	14.0%	14.1%	11.2%	14.0%	17.5%
ROA	4.9%	7.9%	7.5%	7.6%	8.2%	8.0%	7.6%	7.7%	7.8%	4.1%
Uniform ROA vs ROA - Variance	5.8%	3.0%	4.1%	5.2%	4.6%	6.0%	6.6%	3.6%	6.2%	13.4%

**in USD millions*

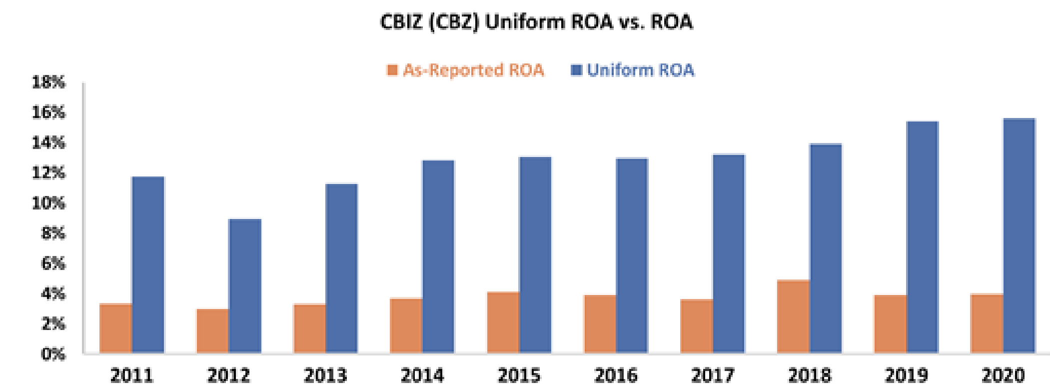
CBZ – Uniform Accounting helps investors see a business's true profitability

Between 2012 and 2020, CBIZ's (CBZ**)** shares increased dramatically, rising from roughly $6/share in 2012 to over $30/share, a gain of more than 400%. And yet, to the market, CBZ appears to be a firm with consistent below cost of capital returns, and not one with fundamental improvements warranting stock appreciation.

However, using Uniform Accounting, we can identify distortions such as a firm's earnings being overstated due to a mistreatment of operating leases. According to as-reported metrics, CBZ maintained an ROA of 3%-5% since 2011, below the cost-of-capital. Meanwhile, UAFRS-adjusted metrics paint a significantly different picture of CBZ, where Uniform ROA expanded materially from 12% to 16% over the same timeframe, suggesting the firm's stock price appreciation may have been justified.



Source: CapitalIQ



Sources: UAFRS, CaptialIQ

CBZ - CBIZ, Inc.	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Rental Expense	39.8	32.6	32.2	33.9	34.3	35.7	37.0	38.4	38.0	37.3
Capitalized operating lease investment	585.9	479.9	474.0	459.1	455.4	452.4	468.9	499.5	516.6	506.7
Uniform earnings	65.8	44.1	51.7	61.3	63.9	65.8	69.7	80.3	89.5	96.7
Net income	28.0	31.1	85.9	29.8	34.1	40.1	50.4	61.6	70.7	78.3
% Variance	-57.4%	-29.3%	65.9%	-51.5%	-46.6%	-39.1%	-27.7%	-23.4%	-21.0%	-19.1%
Uniform net assets	559.2	492.7	459.9	478.8	489.2	507.7	526.6	577.8	581.8	619.9
Total assets	812.4	970.2	897.5	991.2	996.3	1,118.6	1,176.2	1,183.0	1,400.8	1,513.8
% Variance	45.3%	96.9%	95.1%	107.0%	103.7%	120.3%	123.4%	104.7%	140.8%	144.2%
Uniform ROA	11.8%	8.9%	11.2%	12.8%	13.1%	13.0%	13.2%	13.9%	15.4%	15.6%
ROA	3.3%	3.0%	3.3%	3.7%	4.1%	3.9%	3.6%	4.9%	3.9%	4.0%
Uniform ROA vs ROA - Variance	8.4%	5.9%	7.9%	9.1%	8.9%	9.1%	9.6%	9.0%	11.5%	11.6%

**in USD millions*

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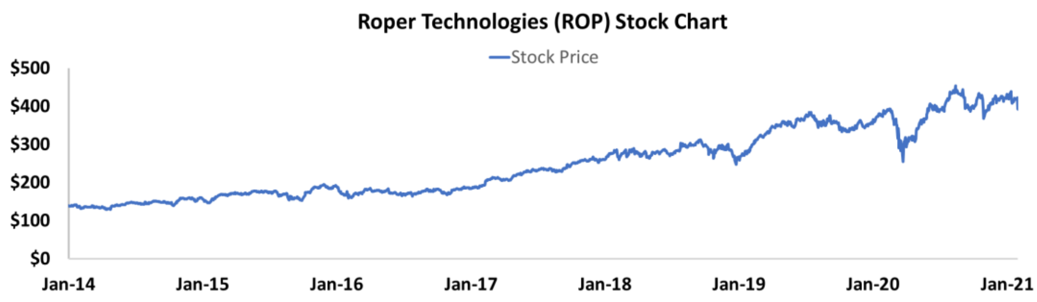
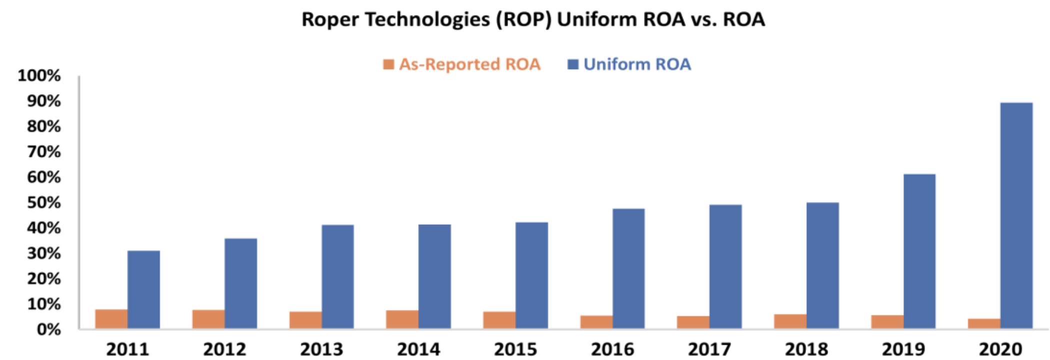
ROP – UAFRS helps tie together financials and economic reality

Since 2014, ROP shares have seen a meaningful stock price appreciation, rising from about $140/share to over $380/share, an increase of almost 200%. And yet, to the market, ROP appears to be a firm with declining below corporate average profitability, which would fail to justify the company's stock performance.

However, using Uniform Accounting, we can identify distortions, such as a firm carrying excess assets on the balance sheet due to goodwill, as is the case with ROP, which substantially suppresses profitability metrics. After making several acquisitions, as-reported metrics make the firm appear to have seen declining, middling returns. However, Uniform metrics paint a significantly different picture of ROP than as-reported metrics, for Uniform ROA has improved markedly, rising from 44% in 2014 to 94% in 2020, demonstrating that the firm's acquisitions have not been value-destructive. As such, recent price trends appear warranted.



Source: CapitalIQ



Sources: UAFRS, CaptialIQ

ROP - Roper Technologies, Inc.	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Goodwill & other intangibles	3,832.3	3,960.6	5,567.7	6,589.1	6,689.4	8,353.7	12,303.0	12,295.5	13,188.9	15,483.1
Uniform earnings	390.4	493.7	619.5	700.5	813.4	930.4	953.1	1,112.1	1,370.7	1,704.6
Net income	322.6	427.2	483.4	538.3	646.0	696.1	658.6	971.8	944.4	1,767.9
% Variance	-17.4%	-13.5%	-22.0%	-23.2%	-20.6%	-25.2%	-30.9%	-12.6%	-31.1%	3.7%
Uniform net assets	1,169.2	1,309.3	1,425.1	1,593.0	1,793.6	1,820.2	1,807.3	2,059.1	2,107.0	1,823.5
Total assets	5,069.5	5,319.4	7,071.1	8,185.0	8,400.2	10,168.4	14,324.9	14,316.4	15,249.5	18,108.9
% Variance	333.6%	306.3%	396.2%	413.8%	368.4%	458.6%	692.6%	595.3%	623.7%	893.1%
Uniform ROA	33.4%	37.7%	43.5%	44.0%	45.4%	51.1%	52.7%	54.0%	65.1%	93.5%
ROA	6.8%	7.9%	7.7%	7.0%	7.6%	7.0%	5.4%	5.3%	5.9%	5.6%
Uniform ROA vs ROA - Variance	26.5%	29.8%	35.8%	37.0%	37.8%	44.2%	47.3%	48.7%	59.1%	87.9%

*in USD millions

Valens Research Glossary

Asset' – Net Asset' is calculated as Net Working Capital + Long Term Non-Depreciating Operating Assets (including Land and Non-Depreciating Operating Intangible Assets, excluding Goodwill and other acquisition-related Intangible Assets) + Inflation-Adjusted Net PP&E + Net capitalized R&D + Net Capitalized Leases + Net Depreciating Operating Intangible Assets

Earnings Call Forensics™ – Valens Research analysis includes a powerful proprietary process for studying and evaluating representations made by management during quarterly earnings calls and other public events. Valens uses tools and systems that other sell-side firms and credit agencies have been either unwilling or unable to use. Their reluctance to use these technologies often stems from their fear of endangering their relationships with management teams.

iCDS – Valens calculates proprietary, Intrinsic CDS (Credit Default Swap) for thousands of firms as their fundamentals change. Early markers can be invaluable in predicting price movements, particularly when seeing credit quality changes where no CDS are traded, where speculative or illiquid CDS fails to provide reliable information, or where rating agencies are too slow.

Most Compelling Earnings Call Forensics™ Inflections – Companies where Earnings Call Forensics™ (ECF™) has identified large shifts in management sentiment from quarter-to-quarter. The ECF™ Ratio above highlights the rate of incidence of Highly Confident and Excitement markers relative to Highly Questionable markers. The higher on the list a name appears, the larger the recent inflection between their two most recent ECF™.

Most Compelling Long Ideas – The most compelling long ideas based on all five proprietary value drivers: UAFRS-adjusted ROA, Asset' Growth, V/A', V/E', and TSRr. These are companies that Valens maintains a positive outlook on, relative to current market valuations. The higher on the list a name appears, the more positive Valens' opinion of the name is, based on our fundamental factors.

UAFRS-adjusted ROA – UAFRS-adjusted ROA is a cleaned up Return on Asset ratio, used to understand the operating fundamentals of the company. UAFRS-adjusted ROA is Earnings' divided by Asset'. Earnings' is calculated as Net Income + Special Items + Interest Expense + Depreciation and Amortization Expense + R&D Expense + Rental Expense + Minority Interest Expense + Pension Charges + LIFO to FIFO adjustments + Stock Option Expense + Purchase Accounting Cash Flow Adjustments - Non-Operating (Investment) Income - Asset Life Based Charge on Depreciating Assets. Asset' is Net Asset', or Net Working Capital + Long-Term Non-Depreciating Operating Assets (including Land and Non-Depreciating Operating Intangible Assets, excluding Goodwill and other acquisition related Intangible Assets) + Inflation Net PP&E + Net Capitalized R&D + Net Capitalized Leases + Net Depreciating Operating Intangible Assets.

UAFRS-adjusted ROA Momentum – UAFRS-adjusted ROA momentum is Valens' metric to understand the change in projected UAFRS-adjusted ROA and earnings momentum. This metric analyzes what the first forecast year projected UAFRS-adjusted ROA was one month ago, and what the projected UAFRS-adjusted ROA is today. This helps in identifying companies where analyst expectations for fundamentals are improving, and companies where analyst expectations for fundamentals are growing more negative.

TSRr – Total Shareholder Returns (TSR) Relative are traditionally known as the capital gains of the stock, adjusted for any stock splits or similar action, plus dividends, over some period of time. No adjustments are made to the well-known standard calculation. TSRr calculates the TSR relative to the performance of the S&P 500 in the USA, or some other major market index if more relevant when examining companies in other countries.

V/A' – V/A' is a cleaned up Enterprise Value to Net Asset ratio, used to understand the multiple on Net Asset that the debt and equity markets value the company at. Generally, businesses that produce higher UAFRS-adjusted ROA's and have no credit concerns or other reasons to believe they are not "going concern" businesses trade at higher V/A'. V is Enterprise Value', defined as Market Cap + Minority Interest + Adjusted Book Debt - Excess Cash. A' is Net Asset', or Net Working Capital + Long-Term Non-Depreciating Operating Assets (including Land and Non-Depreciating Operating Intangible Assets, excluding Goodwill and other acquisition related Intangible Assets) + Inflation Net PP&E + Net Capitalized R&D + Net Capitalized Leases + Net Depreciating Operating Intangible Assets.

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V/E' – V/E' is a cleaned up Enterprise Value to Earnings ratio, used to understand the value the debt and equity markets ascribe to the company's cash flows. V is defined as Enterprise Value', which is Market Cap + Minority Interest + Adjusted Book Debt - Excess Cash. E' is defined as Earnings Prime. Earnings Prime is calculated as Net Income + Special Items + Interest Expense + Depreciation and Amortization Expense + R&D Expense + Rental Expense + Minority Interest Expense + Pension Charges + LIFO to FIFO adjustments + Stock Option Expense + Purchase Accounting Cash Flow Adjustments - Non-Operating (Investment) Income - Asset Life Based Charge on Depreciating Assets.

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