Core Earnings: New Data and Evidence

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Ethan Rouen
Harvard Business School

Eric C. So
Massachusetts Institute of Technology (MIT) - Sloan School of Management

Charles C. Y. Wang
Harvard Business School

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Abstract

Using a novel dataset that comprehensively classifies the quantitative financial disclosures in firms' 10-Ks, including those hidden in the footnotes and the MD&A, we show that disclosures of non-operating and less persistent income-statement items are both frequent and economically significant, and increasingly so over time. Adjusting GAAP earnings to exclude these items creates a measure of core earnings that is highly persistent and that forecasts future performance. Street earnings for firms that meet or just beat analyst expectations are more likely to selectively exclude these items. Analysts and market participants also are slow to impound the implications of these items. Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year.

Keywords: Core Earnings, Transitory Earnings, Non-Operating Earnings, Quantitative Disclosures, Equity Valuation, Big Data

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