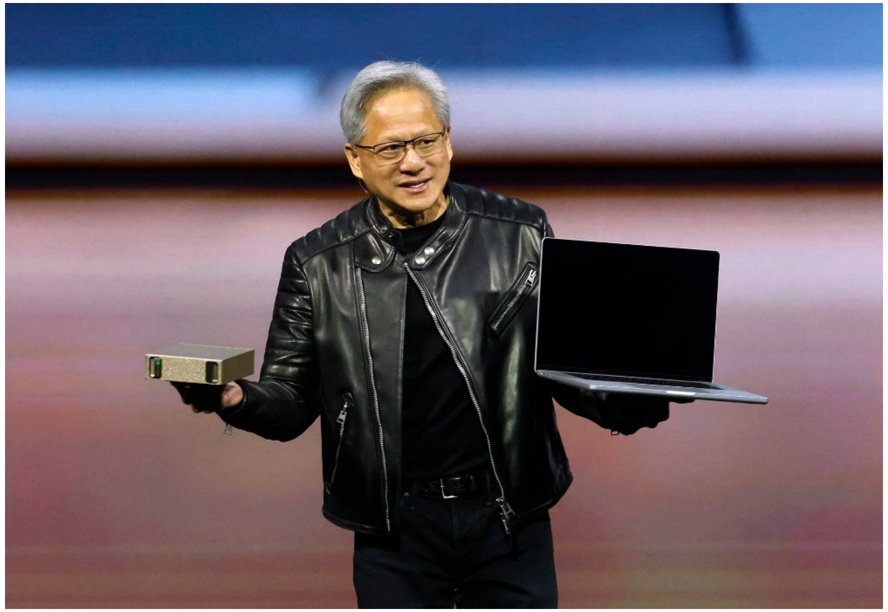


CapEx & Depreciation: Michael Burry vs. AI and Big Tech

Would You Like Some Understated Depreciation with Your Nvidia B200?

Michael Burry, famous from *The Big Short*, recently made waves when he claimed that many Big Tech companies, such as Oracle and Meta, have **overstated** their earnings by **understating** their Depreciation on GPUs and data centers.

So… is he right?

This Lesson: CapEx, Depreciation, and AI Bubbles

Cassandra Unchained
@michaeljburry

Understating depreciation by extending useful life of assets artificially boosts earnings -one of the more common frauds of the modern era.

Massively ramping capex through purchase of Nvidia chips/servers on a 2-3 yr product cycle should not result in the extension of useful lives of compute equipment.

Yet this is exactly what all the hyperscalers have done. By my estimates they will understate depreciation by $176 billion 2026-2028.

By 2028, ORCL will overstate earnings 26.9%, META by 20.8%, etc. But it gets worse. More detail coming November 25th. Stay tuned.

Network/Compute Depreciation Useful Life (Years)

Company	2020	2021	2022	2023	2024	2025
META	3	4	4½	4½	4½	5½
GOOG	3	4	4	6	6	6
ORCL	5	5	5	5	6	6
MSFT	3	4	6	6	6	6
AMZN	4	4	5	5	6	5

This Lesson: CapEx, Depreciation, and AI Bubbles

This video is **not** about whether we're in an AI bubble (yes), whether AI will eliminate all jobs and kill humans (maybe?), or anything else.

Instead, we will just address **this one specific claim** about current AI spending.

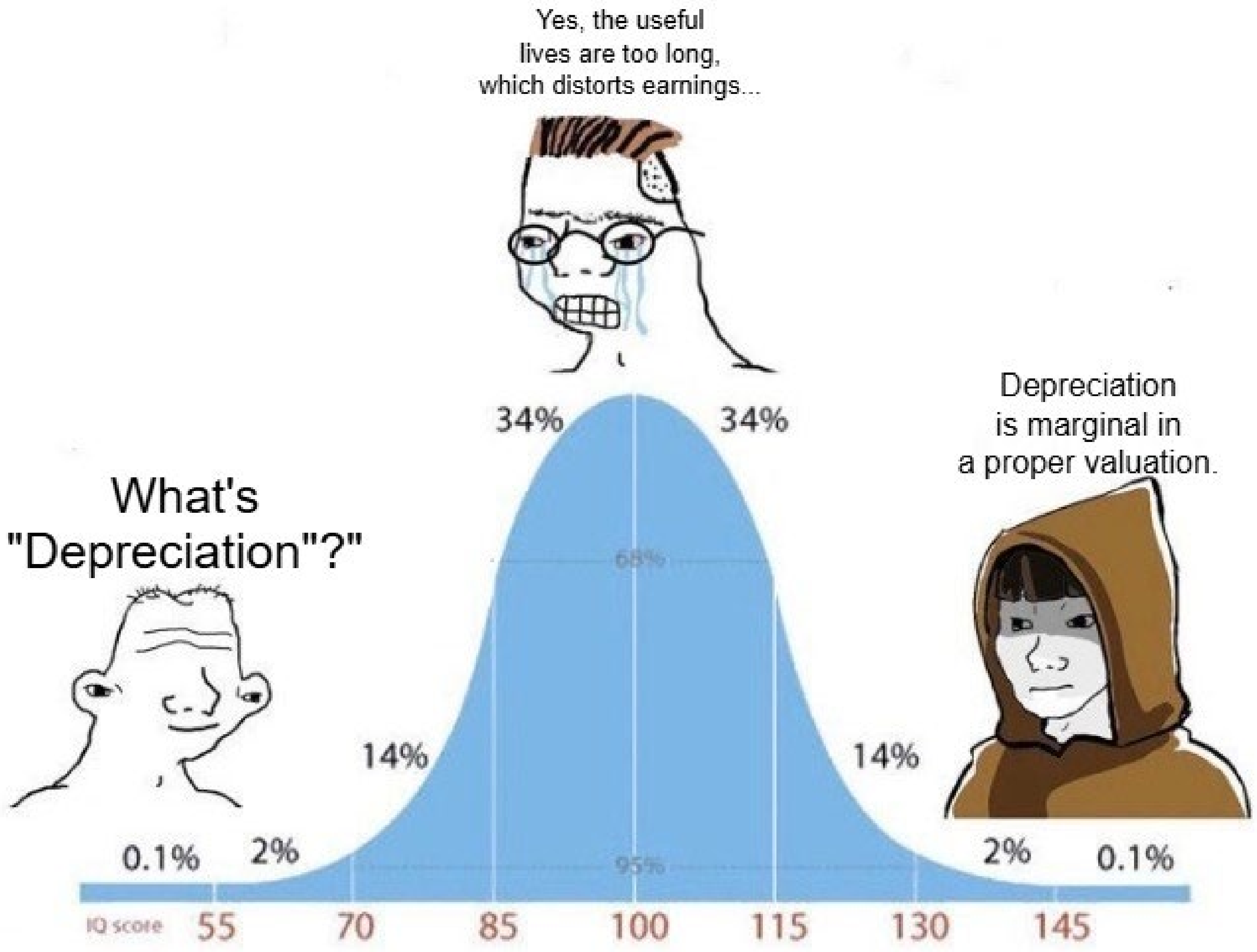
This Lesson: CapEx, Depreciation, and AI Bubbles

For the files and resources, please go to:

https://breakingintowallstreet.com/kb/accounting/capex-depreciation/

(There are several Excel examples illustrating different concepts there.)

The Short Version of CapEx and Depreciation



The Short Version of CapEx and Depreciation

- **ANSWER:** “Earnings” (Net Income) is almost irrelevant to a proper valuation of *technology companies*

- **Why:** You want to use metrics that *normalize* for capital structure and accounting differences, such as EBITDA or even EBITDA – CapEx

- **And:** In a DCF based on long-term Unlevered FCF forecasts, the Depreciation matters mostly for some modest tax effects (higher numbers = greater tax savings)

- **Useful Lives:** Yes, they can affect things, but…

The Short Version of CapEx and Depreciation

- **Useful Lives:** Ironically, depreciating assets like GPUs and data centers *more quickly* – as represented by Depreciation as a higher % of Revenue – could *boost* valuations!

		Depreciation % Revenue:					
		10.0%	11.0%	**12.0%**	13.0%	14.0%	15.0%
CapEx % Revenue:	13.0%	$ 169,344	$ 171,900	**$ 174,457**	$ 177,013	$ 179,570	$ 182,126
	14.0%	159,118	161,675	**164,231**	166,787	169,344	171,900
	15.0%	**148,892**	**151,449**	**154,005**	**156,562**	**159,118**	**161,675**
	16.0%	138,666	141,223	**143,779**	146,336	148,892	151,449
	17.0%	128,441	130,997	**133,554**	136,110	138,666	141,223
	18.0%	118,215	120,771	**123,328**	125,884	128,441	130,997

- **Why:** Shorter useful lives means **the tax savings from Depreciation** are more valuable today

- **But:** Shorter useful lives also imply **higher CapEx** because the company will need to spend more to keep replacing its “no longer useful” assets… so you must consider both factors

CapEx and Depreciation: Lesson Overview

- **Part 1:** CapEx and Depreciation Accounting **5:19**

- **Part 2:** CapEx and Depreciation in Valuation and the DCF **8:57**

- **Part 3:** Why No One is "Right" About This AI CapEx Debate **11:56**

Part 1: CapEx and Depreciation Accounting

- **Simple:** $100 of CapEx on January 1 of the year

- **Statements:** No initial impact on IS; $100 cash outflow on CFS; and Cash down by $100 with Net PP&E up by $100 on BS

- **Depreciation:** (Initial CapEx – Salvage Value) / Useful Life

- **Depreciation:** ($100 – $0) / 10 years = $10 per year

- **Income Statement:** Record the full $10 of Depreciation, so Net Income is down by $7.5 at a 25% tax rate

Part 1: CapEx and Depreciation Accounting

- **CFS:** Net Income is down by $7.5, but add back the $10 of Depreciation since it's non-cash; still have the $100 CapEx, so Cash is down by $97.5

- **Balance Sheet:** Cash is down by $97.5, Net PP&E is up by $90 due to the CapEx and Depreciation, and Equity is down by $7.5 due to the reduced Net Income

- **Balance:** Total Assets are down by $7.5, and so are Total L&E

- **"Earnings":** Only affected by Depreciation – the allocation after the fact – *not* the initial CapEx

Part 2: CapEx and Depreciation in Valuation

- **Ideally:** Use multiples such as TEV / EBITDA that are not affected by Depreciation

- **P / E:** Highly problematic because it's affected by Depreciation, capital structure, interest rates, etc.

- **DCF:** Depreciation is "added back" to calculate Unlevered FCF, but it also reduces the company's taxes

- **KEY QUESTION:** To what extent does higher Depreciation, meaning *shorter useful lives*, imply **higher CapEx** requirements in the future to replace/upgrade assets?

Part 3: Why No One is "Right"

- **Truth:** I have no idea what the proper useful life of an Nvidia GPU is, and this debate skirts around the main issue

- **REAL QUESTION:** How much in additional long-term revenue and cash flow is generated by this AI CapEx?

- **Retail/Restaurant Company:** Easy to establish because it costs \$X to open a new location, and it generates \$Y per year

- **AI and Big Tech:** No one knows because answers are obfuscated, companies don't disclose the data, and we don't know what's "responsible" for the growth

Recap and Summary

- **Part 1:** CapEx and Depreciation Accounting

- **Part 2:** CapEx and Depreciation in Valuation and the DCF

- **Part 3:** Why No One is “Right” About This AI CapEx Debate