18 New Stocks Added to Most Dangerous List

Recap from October Picks

Our Most Dangerous stocks for November were made available at midnight last Wednesday. Our Most Dangerous Stocks (+5.9%) rose more the S&P 500 (+3.7%) last month and underperformed as a short portfolio.

Most Dangerous Small Cap stock Hess Corporation (HES), which was featured in October, fell by 8.8%. 11 out of the 40 Most Dangerous stocks saw price declines.

On to November's Picks

18 new stocks fall onto the Most Dangerous list this month.

Most Dangerous stocks have misleading earnings and long growth appreciation periods implied in their market valuations.

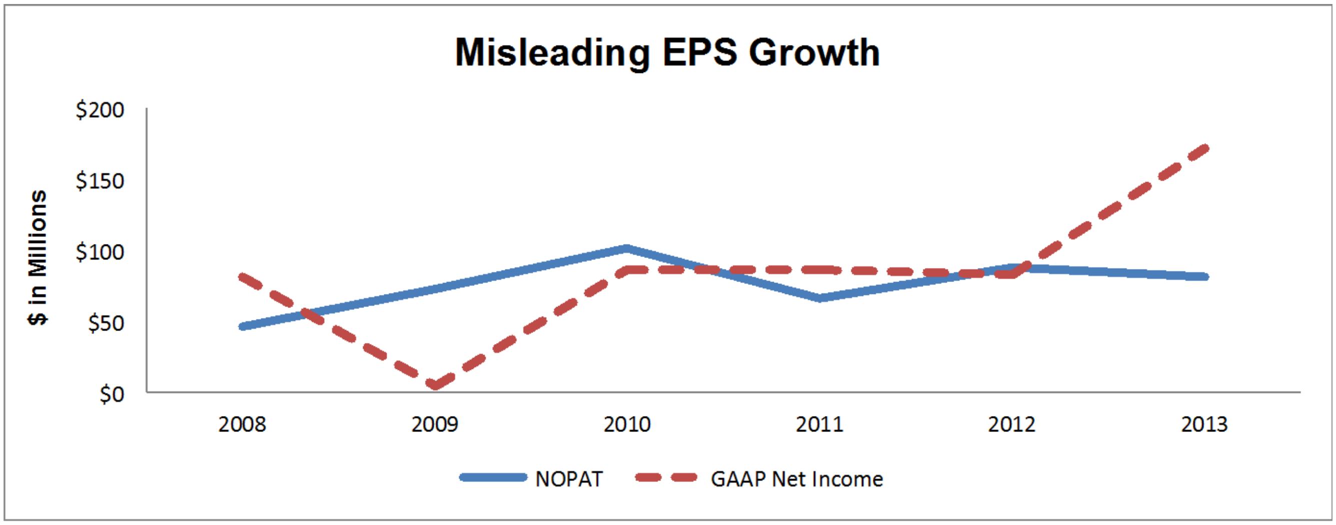
Most Dangerous Stock Feature for November: Mueller Industries, Inc. (MLI)

Mueller Industries (MLI) is one of the new Most Dangerous stocks for November. MLI is very overvalued given its recent history as well as the unusual gains used to boost earnings in 2013.

Mueller's ROIC has declined to 8% in 2013 from 10% in 2010. Over this same time frame, Mueller's after-tax profit (NOPAT) has declined by 7% compounded annually.

Investors would not notice this large decline in profits if relying on GAAP net income. Net income appeared to increase 109% year over year in 2013. However, this jump in net income was due to Mueller's sale of $39 million in manufacturing assets that it recorded as income. After removing this unusual income, as well as over $106 million in non-recurring insurance settlements, we see that much of Mueller's net income of $172 million comes from non-recurring items, which are unrelated to the normal operations of its business. We remove their effect to calculate NOPAT, a truer measure of recurring profits. MLI's NOPAT in 2013 was actually just $81 million, an 8% decline from 2012. Figure 1 shows the disconnect between GAAP net income and NOPAT that occurred in 2013.

Figure 1: NOPAT Flat While Earnings Rise



Source: New Constructs, LLC and company filings

Mueller's true earnings in 2013 would be the same as they were in 2012 if not for the unusual gains. This flat trend is more indicative of earnings so far in 2014 as operating income in 3Q14 was down over 50% from the year before. Just looking at GAAP EPS in 2013 misleads investors into thinking MLI is more profitable than it really is. Getting to the real numbers helps see the true profitability and make a more informed decision.

Why MLI's Valuation is Unwarranted

Taking the above into account, MLI's overvaluation is rather alarming. To justify its current price of ~$32/share, Mueller must grow NOPAT by 15% compounded annually for the next 16 years. Considering that Mueller's 2014 profits look to continue the flat to downward trend in NOPAT since 2010, we think it is unlikely that the company will suddenly grow profits at a rate anywhere close to 15% annually. It's easy to see that the expectations embedded into Mueller's stock price are dangerously high.

Kyle Guske II contributed to this report.
Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, sector, or theme.

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