



New Stocks on Most Attractive/Most Dangerous Lists: June 2015

Recap from May Picks

Our Most Attractive Stocks (+2.5%) outperformed the S&P 500 (+1.5%) last month. Most Attractive Large Cap stock Goodyear Tire & Rubber (GT) gained 16% and Most Attractive Small Cap stock Triple-S Management Corp (GTS) was up nearly 25%. Overall, 19 out of the 40 Most Attractive stocks outperformed the S&P 500 in May.

Our Most Dangerous Stocks (1.5%) rose slightly less than the S&P 500 (1.5%) last month. Most Dangerous Small Cap stock and 3/23/15 [Danger Zone pick El Pollo Loco Holdings](#) (LOCO) fell by 20% and Most Dangerous Large Cap Stock Manitowoc (MTW) fell by 2%. Overall, 20 out of the 40 Most Dangerous stocks outperformed the S&P 500 in May.

The successes of the Most Attractive and Most Dangerous stocks highlight the value of our forensic accounting. Being a [true value investor](#) is an increasingly difficult, if not impossible, task considering the amount of data contained in the ever-longer annual reports. By analyzing key details in these SEC filings, our research protects investors' portfolios and allows our clients to execute value-investing strategies with more confidence and integrity.

20 new stocks make our Most Attractive list this month and 21 new stocks fall onto the Most Dangerous list this month. June's Most Attractive and Most Dangerous stocks were made available to members on June 3.

Our Most Attractive stocks have high and rising return on invested capital ([ROIC](#)) and low [price to economic book value ratios](#). Most Dangerous stocks have [misleading earnings](#) and long [growth appreciation periods](#) implied by their market valuations.

Most Attractive Stock Feature for June: RPX Corporation (RPXC: ~\$16/share)

RPX Corporation (RPXC), provider of patent management services, is one of the additions to our Most Attractive stocks for June. Despite RPX Corporation's strong underlying fundamentals, the stock remains undervalued and has excellent upside.

RPX Corporation boasts a ROIC of 27%, placing it in the top quintile of all the companies we cover. Such a high ROIC is a great sign of the company's ability to generate returns on the money being invested into the business. In addition to an excellent ROIC, RPX Corporation has grown its after-tax profit ([NOPAT](#)) by 7% compounded annually since 2011.

On a trailing-twelve month basis (TTM), RPX Corporation has grown its NOPAT by 31% while also increasing its ROIC over 2014 levels. The company increased its free cash flow to \$44 million on a TTM basis, giving the company a 7.4% [free cash flow yield](#).

Despite the growing patent litigation industry and RPX Corporation's strong business fundamentals, the stock price is down 4% over the past year. This drop puts shares below their economic book value. At its current price of ~\$16/share, RPXC has a price to economic book value ratio ([PEBV](#)) of 0.9, which means the market expects RPX Corporation's NOPAT to permanently decline by 10%.

Those expectations seem rather pessimistic when considering RPX Corporation has grown NOPAT by 7 % compounded annually since 2011 and over 31% in the past twelve months.

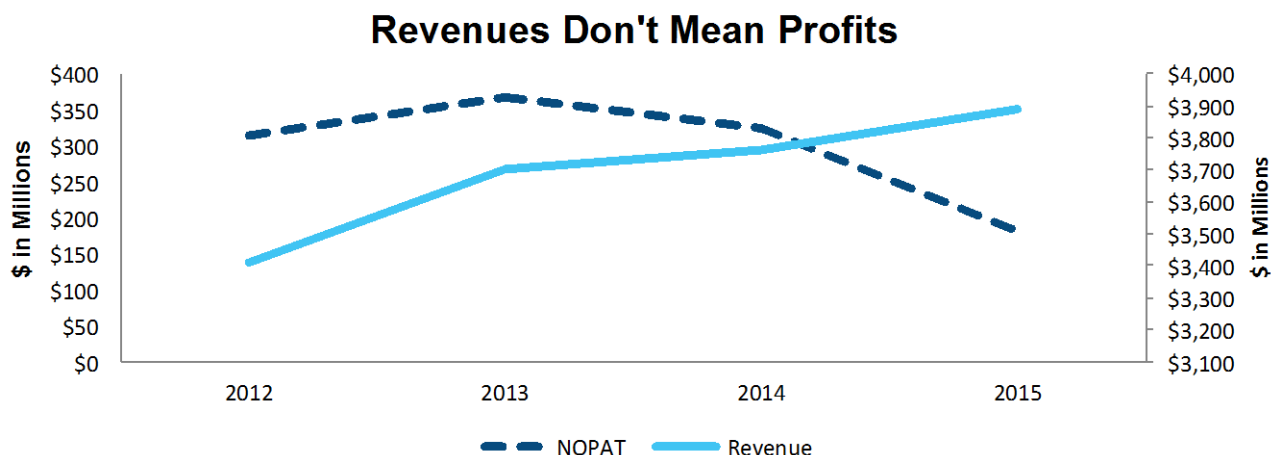
If RPX Corporation can grow NOPAT by 8% compounded annually over the next six years, the stock is worth \$20/share today – a 25% upside. Undervalued companies are increasingly harder to find. Investors should take a close look at RPXC.

**Most Dangerous Stock Feature: Triumph Group, Inc. (TGI: ~\$68/share)**

Triumph Group, Inc. (TGI), an aerospace designer and manufacturer is one of the additions to our Most Dangerous stocks for June. The stock is dangerously overvalued considering the market has not yet priced in the company's declining fundamentals.

Despite increasing revenue at a 4% compounded annual rate since 2012, Triumph's after-tax profit (NOPAT) has declined by 17% compounded annually. Narrowing pre-tax (NOPBT) margins, from 14% in 2012 to 7% in 2015, caused profits to drop precipitously even while revenues rose.

Figure 1: Rising Revenue Obscures Falling Profits



Sources: New Constructs, LLC and company filings

Not surprisingly, the company's [ROIC](#) has fallen as well: from 8% in 2012 to a bottom-quintile 3% in 2015.

Forensic Accounting Reveals Overstated EPS

Triumph Group currently trades at a hefty price despite its deteriorating fundamentals. This disconnect between price and profits appears to be a result of too much reliance on reported earnings. After removing over \$80 million in [non-operating income](#) from the income statement, largely from gains on legal settlements, we see that the true recurring cash flows of the business declined in 2015. This decline runs counter to revenue and the reported 15% increase in net income. Forensic accounting is increasingly needed to protect investors from accounting shenanigans.

Why TGI is Not a Stock to Consider Buying

Taking all the above into account, Triumph Group's expensive valuation looks very risky. Our DCF models explain just how overvalued some stocks can be. To justify its current price of ~\$68/share, Triumph Group must grow NOPAT by 7% compounded annually for the next 24 years. Considering that Triumph Group's NOPAT has been decreasing for the past 5 years, betting on the company to reverse its declining profits and sustain new profit growth for such an extended period of time seems like a risky bet. Why take so much risk in TGI when you have an alternative like RPXC?

Disclosure: David Trainer and Max Lee receive no compensation to write about any specific stock, style, or theme.



New Constructs® – Profile

How New Constructs Creates Value for Clients

1. **Superior Recommendations** – Our [stock picks](#) consistently outperform. See our track record in our [stock-picking accolades](#) and [Proof Is In Performance](#) reports.
2. **More Accurate Research** – Our [patented Research Platform](#) for [reversing accounting distortions](#) and [discounted cash flow analysis](#) leverages better data to deliver smarter research.
3. **Time Savings** – We check the fine print in thousands of corporate filings so you don't have to. As reported by [Barron's](#), our expertise in analyzing SEC filings delivers [Hidden Gems and Red Flags](#) that drive long-term stock-picking success.
4. **Transparency** – We are proud to share the results of our analysis of over 50,000 10Ks. See the [Corporate Disclosure Transgressions](#) report we provided the SEC. Our reports detail all data and assumptions. Company Models enable users to change them.
5. **Objectivity** – New Constructs is an independent research firm, not tied to Wall Street or investment banking services. Our models are driven by comprehensive high-quality data not stories. See our [presentation to the Senate Banking Committee](#), the SEC and many others in DC.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. [Accounting data must be translated into economic earnings](#) to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. [Economic earnings](#) are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

Additional Information

Incorporated in July 2002, [New Constructs](#) is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. [NOPAT](#), [Invested Capital](#), and [WACC](#), to create [economic earnings models](#), which are necessary to understand the true profitability and valuation of companies. Visit the [Free Archive](#) to download samples of our research. New Constructs is a [BBB accredited](#) business and a member of the [Investorside Research Association](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

New Constructs is affiliated with Novo Capital Management, LLC, the general partner of a hedge fund. At any particular time, New Constructs' research recommendations may not coincide with the hedge fund's holdings. However, in no event will the hedge fund receive any research information or recommendations in advance of the information that New Constructs provides to its other clients.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.