ELECTRONIC INVESTOR

Where to Get the Best Accounting Analysis

Websites New Constructs and GuruFocus help investors get the benefit of first-rate analysis of corporate accounting.

By MIKE HOGAN
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Fundamental investors lean heavily on corporate financial statements for the data needed to estimate stock values. That's no good, says New Constructs founder David Trainer—or at least not good enough at today's lofty valuations.

"There's a whole lot of money chasing precious few decent stocks," claims Trainer, "and the rest of the money is pushing other stock prices too high."

Of the 3,000 U.S.-listed stocks that New Constructs' (newconstructs.com) analysts track closely, only about 10% are "attractive" by the firm's estimates. Approximately two-thirds are "dangerous" because of risk factors not illuminated by financial statements, says Trainer, a forensic accountant by profession. The rest are rated "neutral."

Generally accepted accounting principles, the language of accrual accounting, can help prudent managers manage and lenders determine suitable levels of leverage. Expense and revenue are booked as they incur as opposed to when cash changes hands. As a result, there can be disparities between net profits reported and actual cash generated. GAAP line items are backward looking and don't necessarily address future values that investors care most about. Then, too, key events, competitive advantages, and shortcomings often get buried in not-quite-forthcoming report notations.

Investors have to interpret them and adjust GAAP values to calculate return on capital and free cash flow—or pay someone like Trainer to do it. His analysts turn corporate financials into detailed reports focused on prospects, rating stocks from "very attractive" to "very dangerous."

Such analysis isn't cheap. Most New Constructs stock- and fund-evaluating services are sold to institutions and priced a la carte. But its most-attractive and most-dangerous stock lists for retail investors have just been discounted 80%, to $10 a month each (https://www.newconstructs.com/nc/offer/trial.htm).

On Sept. 4, shares in one of those picks, Bolt Technology (ticker: BOLT), jumped 36%, to $21.93, on news of its acquisition by Teledyne Technologies (TDY). Bolt was New Constructs' fourth-most-attractive pick in the energy sector.

Fundamental investors like Teledyne look for companies whose market price is below a reasonable calculation of intrinsic value per share. New Constructs offers a shortcut, the price-to-economic-book value (P/EBV) ratio, where EBV is a per-share intrinsic value calculation. A ratio of one means the market price and true value are in rough parity, so the 0.91 P/EBV of very attractive pick IBM (IBM) suggests a 9% discount from economic value and a realistic chance for a price gain.

The real value of the metric is as a red flag, says Trainer. Market-leading refiner Valero Energy (VLO) garners a very dangerous rating—in part because of a 1.92 P/EBV. New Constructs estimates that its share price, which has risen more than 50% in the past year, is almost twice its calculated value.

How long will Valero's management need to generate free cash flow for its economic book value to catch up to its market price? More than 100 years, according to another unique New Constructs metric—growth-appreciation period. A GAP of 100 is typical of dangerous tickers, while attractive companies like IBM and Bolt usually have a GAP in the low-single digits.

GuruFocus (gurufocus.com) is another Website that highlights financial blemishes in the 17,000 North American tickers that it tracks. It prominently displays warning signs at the top of its stock profile pages based on 32 measures of financial strength, profitability, growth, and valuation. A premium feature requiring a $349-a-year subscription: Warning signs are rated either "severe" or "medium."

For example, among Nokia Oyj's (NOK) two severe warnings is a five-year decline in revenue per share (gurufocus.com/analysis/nok) that marks its fall from cellphone pre-eminence. Less obvious is its excessive gap between cash flow from operations and reported net income. A classic loophole enabled by accrual accounting, that shortcoming is behind many of the dangerous ratings New Constructs has handed out lately.

No stock is perfect, and none trades without risks. But it helps to know what they are going in.

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