New Stocks on Most Attractive/Most Dangerous: March 2017

Recap from February Picks

Most Attractive Large Cap stock Cisco Systems (CSCO) gained 10% last month. Most Attractive Small Cap stock The Goldfield Corp (GV) was up 21%. Overall, 7 out of the 40 Most Attractive stocks outperformed the S&P 500 in February and 22 had positive returns.

Our Most Dangerous Stocks (+1.4%) outperformed the S&P 500 (+3.6%) last month. Most Dangerous Large Cap stock Integrated Device Technology (IDTI) fell by 4%. Most Dangerous Small Cap Stock Matrix Service Company (MTRX) fell by 25%. Overall, 17 out of the 40 Most Dangerous stocks outperformed the S&P 500 in February.

The successes of the Most Attractive and Most Dangerous stocks highlight the value of our forensic accounting research (featured in Barron's). Our research helps clients fulfill fiduciary duties when making investment decisions.

33 new stocks make our Most Attractive list this month and 14 new stocks fall onto the Most Dangerous list this month. March's Most Attractive and Most Dangerous stocks were made available to members on 3/2/17.

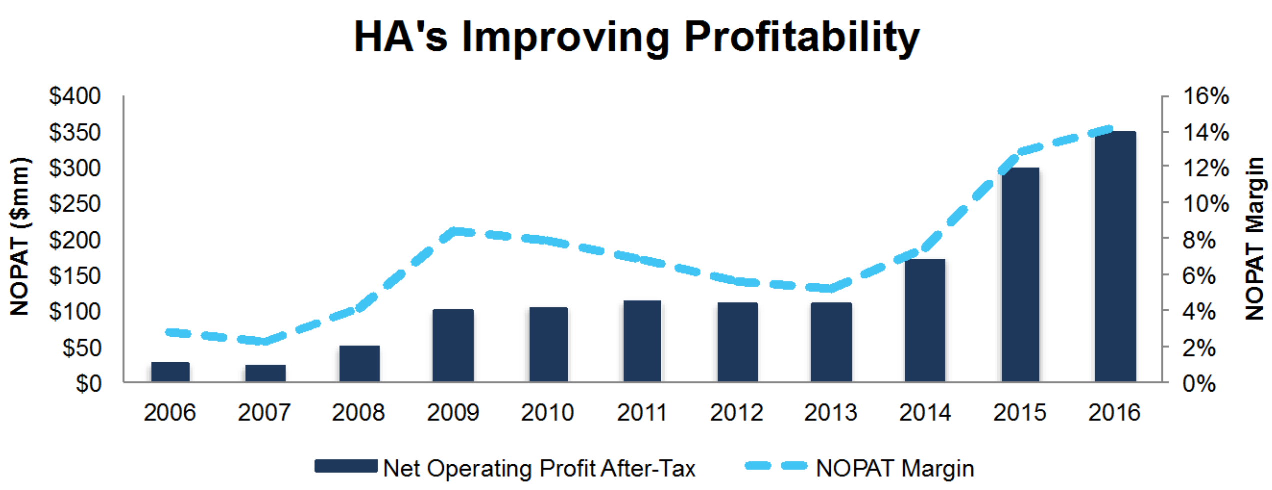
Our Most Attractive stocks have high and rising returns on invested capital (ROIC) and low price to economic book value ratios. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

Most Attractive Stocks Feature for March: Hawaiian Holdings, Inc. (HA: $48/share)

Hawaiian Holdings, Inc. (HA) is one of the additions to our Most Attractive stocks for March.

Over the past decade, Hawaiian Holdings has grown after-tax profit (NOPAT) by 30% compounded annually to $347 million in 2016. Per Figure 1, Hawaiian Holdings has also improved its NOPAT margin from 3% in 2006 to 14% in 2016.

Figure 1: Hawaiian Holdings' Improving NOPAT & NOPAT Margin



Sources: New Constructs, LLC and company filings

Hawaiian Holdings currently earns a top-quintile 15% return on invested capital (ROIC), which is up from 2% in 2006. Hawaiian Holdings has generated a cumulative $381 million (15% of market cap) in free cash flow over the past decade.

HA Valuation Has Significant Upside

Despite solid fundamentals, HA is down 15% year to date while the S&P is up 6%. This price decline has left shares significantly undervalued. At its current price of $48/share, Hawaiian Holdings has a price to economic book value (PEBV) ratio of 0.6. This ratio means the market expects Hawaiian Holdings' profits to permanently decrease by 40%. This expectation seems rather pessimistic for a company that has grown NOPAT by 30% compounded annually over the past decade.

If Hawaiian Holdings can achieve a 12% NOPAT margin (compared to 14% in 2016) and grow NOPAT by just 3% compounded annually for the next five years, the stock is worth $87/share today – an 81% upside.

Impacts of Footnotes Adjustments and Forensic Accounting

Our robo-analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill fiduciary duties.

In order to derive the true recurring cash flows, an accurate invested capital, and an accurate shareholder value, we made the following adjustments to HA's 2016 10-K:

Income Statement: we made $350 million of adjustments, with a net effect of removing $111 million in non-operating expense (5% of revenue). We removed $119 million in non-operating income and $231 million in non-operating expenses. You can see all the adjustments made to HA's income statement here.

Balance Sheet: we made $1.5 billion of adjustments to calculate invested capital with a net increase of $365 million. One of the largest adjustments was $704 million due to off-balance sheet operating leases. This adjustment represented 37% of reported net assets. You can see all the adjustments made to HA's balance sheet here.

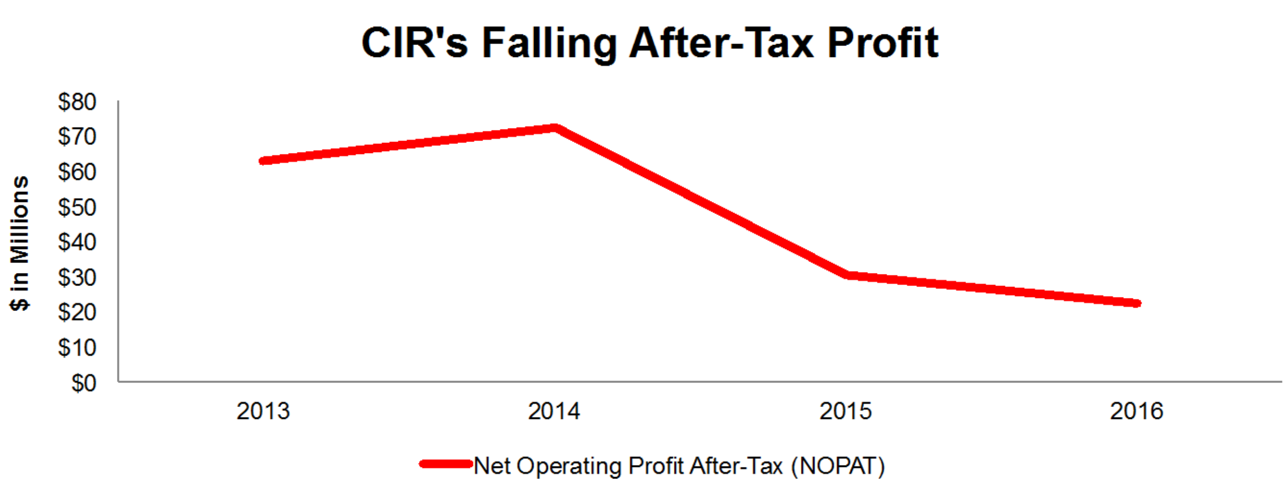
Valuation: we made $2.3 billion of adjustments with a net effect of decreasing shareholder value by $1.3 billion. Apart from total debt, which includes $704 million in operating leases noted above, the largest adjustment to shareholder value was $360 million in underfunded pensions. This adjustment represents 14% of Hawaiian Holding's market cap. Despite these claims on shareholder value, HA remains undervalued.

Most Dangerous Stocks Feature: CIRCOR International, Inc. (CIR: $63/share)

CIRCOR International, Inc. (CIR) is one of the additions to our Most Dangerous stocks for March.

Since 2013, CIRCOR's NOPAT has declined 29% compounded annually, per Figure 1. This deterioration in profits coincides with NOPAT margins falling from 7% in 2013 to 4% in 2016.

Figure 2: CIR's Declining NOPAT



Sources: New Constructs, LLC and company filings

CIRCOR's ROIC has fallen from 10% in 2013 to a bottom-quintile 3% in 2016. The company has also burned through a cumulative $63 million (6% of market cap) in FCF over the past five years.

CIR Is Priced For Perfection

CIR is up 54% over the past year while the S&P is up 19%. This price appreciation amidst deteriorating fundamentals makes CIR significantly overvalued. To justify its current price of $63/share, CIR must grow NOPAT by 15% compounded annually for the next 12 years. This scenario seems overly optimistic given CIRCOR's NOPAT has declined by 29% compounded annually since 2013.

Even if CIR can grow NOPAT at a more reasonable, yet still optimistic, 10% compounded annually for the next decade, the stock is worth $31/share today – a 51% downside.

Each of these scenarios assumes CIRCOR is able to grow revenue and NOPAT/free cash flow without spending on working capital or fixed assets. This assumption is unlikely but allows us to create very optimistic scenarios that demonstrate how high expectations in the current valuation are. For reference, CIR's invested capital has grown on average $61 million (10% of 2016 revenue) per year over the last five years.

Impacts of Footnotes Adjustments and Forensic Accounting

Our robo-analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill fiduciary duties.

In order to derive the true recurring cash flows, an accurate invested capital, and an accurate shareholder value, we made the following adjustments to CIRCOR's 2016 10-K:

Income Statement: we made $51 million of adjustments, with a net effect of removing $12 million in non-operating expense (2% of revenue). We removed $19 million in non-operating income and $32 million in non-operating expenses. You can see all the adjustments made to CIR's income statement here.

Balance Sheet: we made $470 million of adjustments to calculate invested capital with a net increase of $76 million. One of the largest adjustments was $155 million due to midyear acquisitions. This adjustment represented 22% of reported net assets. You can see all the adjustments made to CIR's balance sheet here.

Valuation: we made $343 million of adjustments with a net effect of decreasing shareholder value by $285 million. One of the most notable adjustments to shareholder value was the removal of $278 million in total debt, which includes $27 million in operating leases. This lease adjustment represents 3% of CIRCOR's market cap.

This article originally published here on March 9, 2017.

Disclosure: David Trainer, Kyle Guske II, and Kyle Martone receive no compensation to write about any specific stock, style, or theme.

Follow us on Twitter, Facebook, LinkedIn, and StockTwits for real-time alerts on all our research.

New Constructs® – Profile

How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensic accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

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.

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.