Featured Stocks in May's Most Attractive/Most Dangerous Model Portfolios

10 new stocks make our Most Attractive list this month, and eight new stocks fall onto the Most Dangerous list this month. May's Most Attractive and Most Dangerous stocks were made available to members on May 2, 2019.

The successes of these model portfolios highlight the value of our machine learning and AI Robo-Analyst technology[1], which helps clients fulfill the fiduciary duty of care and make smarter investments[2].

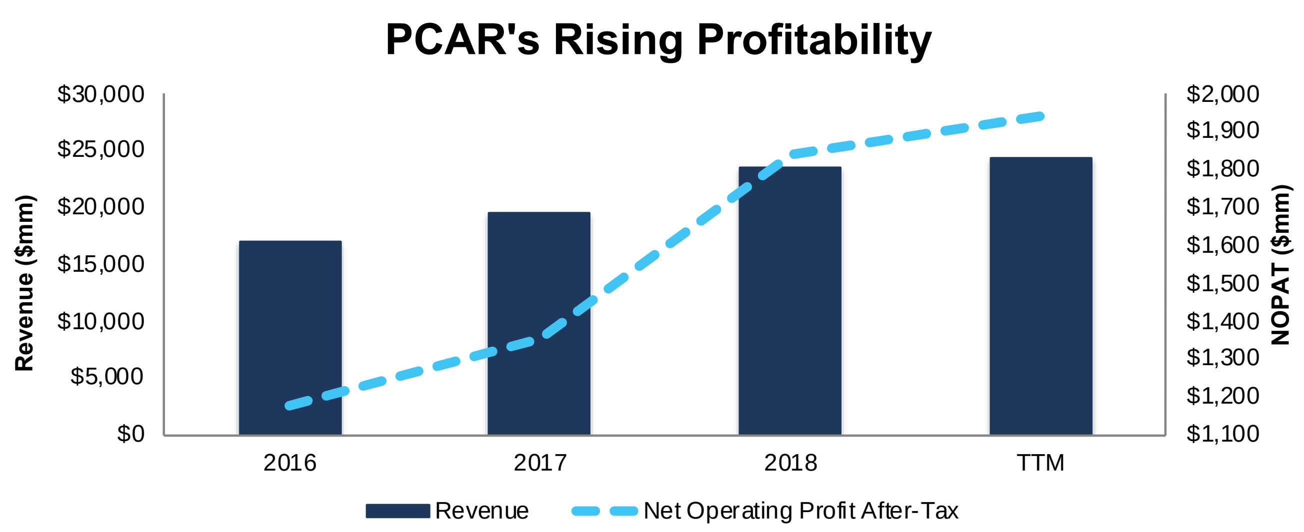
Our Most Attractive stocks have high and rising returns on invested capital (ROIC) and low price to economic book value ratios. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

Most Attractive Stocks Feature for May: PACCAR Inc. (PCAR: $69/share)

PACCAR Inc. (PCAR) is the featured stock from May's Most Attractive Stocks Model Portfolio.

Since 2016, PCAR has grown revenue by 17% and after-tax operating profit (NOPAT) by 25% compounded annually. PCAR's $1.9 billion NOPAT over the trailing twelve months (TTM) is up 20% over the prior TTM period. Profit growth has been fueled by rising NOPAT margins, which are up from 7% in 2016 to 8% TTM. PCAR's return on invested capital (ROIC) has improved from 14% to 19% over the same time.

Figure 1: PCAR Revenue & NOPAT Since 2016



Sources: New Constructs, LLC and company filings

PCAR Valuation Provides Significant Upside

At its current price of $69/share, PCAR has a price-to-economic book value (PEBV) ratio of 1.0. This ratio means the market expects PCAR's NOPAT never to grow from its current level. This expectation seems overly pessimistic for a firm that has grown NOPAT by 8% compounded annually since 1998.

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] Ernst & Young's recent white paper "Getting ROIC Right" demonstrates the superiority of our stock research and analytics.

If PCAR can maintain TTM NOPAT margins (8%) and grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $83share today – a 20% upside. See the math behind this dynamic DCF scenario.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments we make based on Robo-Analyst findings in PACCAR's 2018 10-K:

Income Statement: we made $374 million of adjustments, with a net effect of removing $354 million in non-operating expenses (2% of revenue). You can see all the adjustments made to PCAR's income statement here.

Balance Sheet: we made $5.9 billion of adjustments to calculate invested capital with a net decrease of $1.9 billion. One of the largest adjustments was $1.2 billion in deferred tax. This adjustment represented 11% of reported net assets. You can see all the adjustments made to PCAR's balance sheet here.

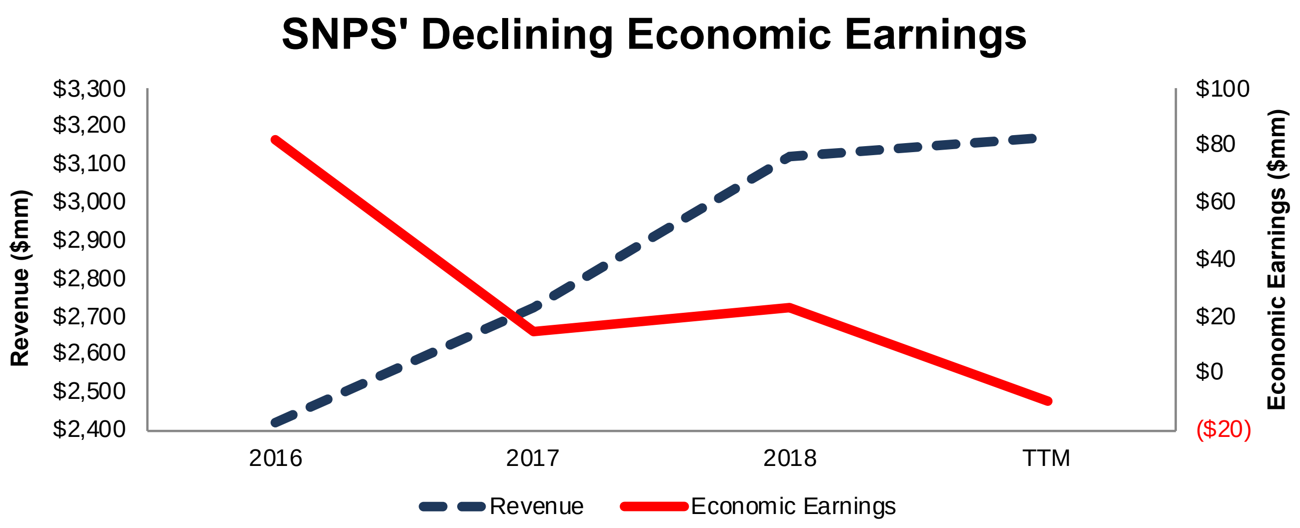
Valuation: we made $3.2 billion of adjustments with a net effect of increasing shareholder value by $2.1 billion. The largest adjustment to shareholder value was $2.6 billion in excess cash. This adjustment represents 11% of PCAR's market cap. See all adjustments to PCAR's valuation here.

Most Dangerous Stocks Feature: Synopsys Inc. (SNPS: $120/share)

Synopsys Inc. (SNPS) is the featured stock from May's Most Dangerous Stocks Model Portfolio.

Since 2016, SNPS has grown revenue by 14% compounded annually. However, economic earnings, the true cash flows of the business, have declined from $82 million in 2016 to -$10 million TTM. SNPS may be growing revenue, but it's getting worse at turning that revenue into profit. SNPS' NOPAT margins fell from 12% in 2016 to 11% TTM while its ROIC fell from 9% to 7% over the same time.

Figure 2: SNPS' Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

SNPS Provides Poor Risk/Reward

Despite the deterioration in fundamentals, SNPS is still priced for significant profit growth and is overvalued.

To justify its current price of $120/share, SNPS must maintain TTM margins (11%) and grow NOPAT by 15% compounded annually for the next 13 years. See the math behind this dynamic DCF scenario. This expectation seems lofty given that SNPS has grown NOPAT by just 6% compounded annually over the past decade.

Even if SNPS can maintain TTM margins and grow NOPAT by 8% compounded annually for the next decade, the stock is worth just $52/share today – a 57% downside. See the math behind this dynamic DCF scenario.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments we make based on Robo-Analyst findings in Synopsys' 2018 10-K:

Income Statement: we made $306 million of adjustments, with a net effect of removing $104 million in non-operating income (3% of revenue). You can see all the adjustments made to SNPS' income statement here.

Balance Sheet: we made $3.2 billion of adjustments to calculate invested capital with a net increase of $791 million. One of the largest adjustments was $463 million in goodwill. This adjustment represented 11% of reported net assets. You can see all the adjustments made to SNPS' balance sheet here.

Valuation: we made $1.7 billion of adjustments with a net effect of decreasing shareholder value by $880 million. The largest adjustment to shareholder value was $437 million in off-balance-sheet operating leases. This adjustment represents 2% of SNPS' market cap. See all adjustments to SNPS' valuation here.

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

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3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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