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

Recap From May's Picks

Our Most Attractive Stocks (+1.4%) outperformed the S&P 500 (+0.8%) from May 5, 2021 through June 1, 2021 by 0.6%. The best performing large cap stock gained 12% and the best performing small cap stock was up 30%. Overall, 21 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+3.9%) underperformed the S&P 500 (+0.8%) as a short portfolio from May 5, 2021 through June 1, 2021 by 3.1%. The best performing large cap stock fell by 3% and the best performing small cap stock fell by 8%. Overall, 10 out of the 26 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios underperformed as an equal-weighted long/short portfolio by 1.3%.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research. Our proprietary Robo-Analyst Technology[1] scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

13 new stocks make our Most Attractive list this month, and 13 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, 2021.

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 June: O'Reilly Automotive, Inc. (ORLY: $528/share)

O'Reilly Automotive, Inc. is the featured stock from June's Most Attractive Stocks Model Portfolio.

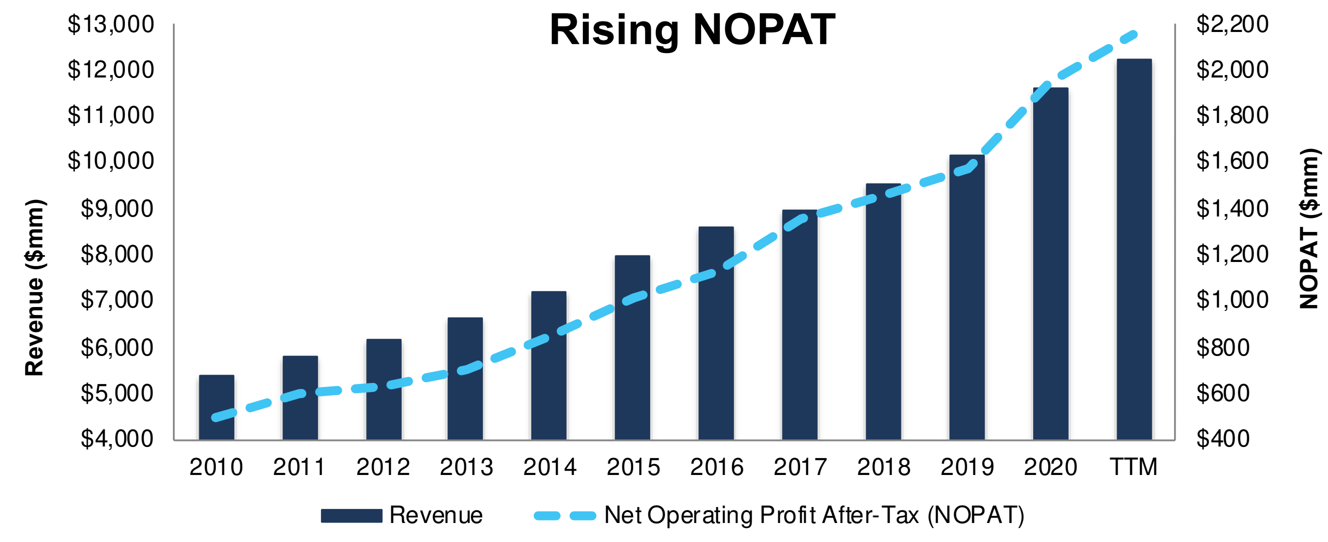
O'Reilly grew revenue by 8% compounded annually and net operating profit after-tax (NOPAT) by 15% compounded annually over the past decade. Longer term, O'Reilly grew NOPAT by 19% compounded annually over the past 20 years.

The firm's NOPAT margin increased from 9% in 2010 to 18% over the trailing twelve months (TTM), while its invested capital turns increased from 1.1 to 1.9 over the same period. Rising margins and invested capital turns drive an improvement in O'Reilly's ROIC from 10% in 2010 to 33% TTM.

Over the past five years, O'Reilly generated $6.5 billion (18% of market cap) in cumulative free cash flow (FCF). Over the TTM, O'Reilly has generated $3 billion in FCF.

[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models overcome flaws in Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

Figure 1: Revenue & NOPAT Since 2010



Sources: New Constructs, LLC and company filings

ORLY Is Undervalued

At its current price of $528/share, ORLY has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects O'Reilly's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 14% compounded annually over the past five years.

Even if O'Reilly's NOPAT margin falls to 16% (equal to its three-year average, compared to 20% TTM) and the firm grows revenue by just 3% compounded annually for the next decade, the stock is worth $697/share today – a 32% upside. See the math behind this reverse DCF scenario. Should O'Reilly grow profits in line with historical levels, the stock has even more upside.

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

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in O'Reilly's 10-K and 10-Q:

Income Statement: we made $307 million of adjustments, with a net effect of removing $194 million in non-operating expenses (2% of revenue). You can see all the adjustments made to O'Reilly's income statement here.

Balance Sheet: we made $528 million of adjustments to calculate invested capital with a net decrease of $224 million. One of the most notable adjustments was $102 million in operating leases. This adjustment represented 2% of reported net assets. You can see all the adjustments made to O'Reilly's balance sheet here.

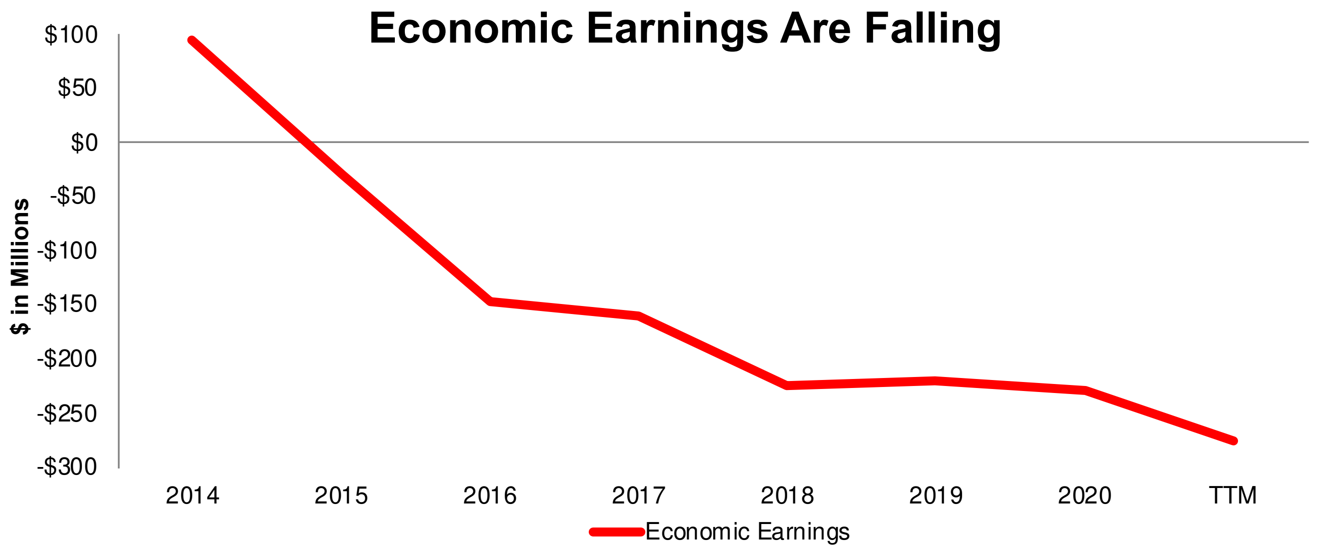
Valuation: we made $7.3 billion of adjustments with a net impact of decreasing shareholder value by $6.6 billion. Apart from total debt, which includes the operating leases mentioned above, one of the most notable adjustments to shareholder value was $367 million in excess cash. This adjustment represents 1% of O'Reilly's market cap. See all adjustments O'Reilly's valuation here.

Most Dangerous Stocks Feature: Kirby Corporation (KEX: $66/share)

Kirby Corporation (KEX) is the featured stock from June's Most Dangerous Stocks Model Portfolio.

Kirby Corporation's economic earnings, the true cash flows of the business, fell from $94 million in 2014 to -$276 million over the TTM. The firm's NOPAT margin fell from 14% in 2014 to 4% TTM, while invested capital turns fell from 0.7 to 0.3 TTM over the same time. Falling NOPAT margins and invested capital turns drive Kirby Corporation's ROIC from 10% in 2014 to 1% TTM.

Figure 2: Economic Earnings Since 2014



Sources: New Constructs, LLC and company filings

KEX Provides Poor Risk/Reward

Despite its poor fundamentals, KEX is still priced for significant profit growth and is overvalued.

To justify its current price of $66/share, Kirby Corporation must improve its NOPAT margin to 7% (three-year average vs. 4% TTM) and grow NOPAT by 13% compounded annually for the next decade. See the math behind this reverse DCF scenario. Given Kirby Corporation's fell 10% compounded annually from 2014 to 2019 before the COVID-19 pandemic, we think these expectations are overly optimistic.

Even if Kirby Corporation improves its NOPAT margin to 7% and grows NOPAT by 8% compounded annually for the next decade, the stock is worth just $30/share today, a 55% downside to the current stock price. See the math behind this reverse DCF scenario. This scenario assumes Kirby Corporation grows revenue by 6% (equal to consensus revenue estimate CAGR of 6% through 2022) compounded annually over the next 10 years. Should Kirby Corporation's revenue grow at a slower rate, the stock has even more downside.

Each of these scenarios also assumes Kirby Corporation is able to grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create best-case scenarios that demonstrate how high expectations embedded in the current valuation are.

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

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in Kirby Corporation's 10-K and 10-Q:

Income Statement: we made $850 million of adjustments, with a net effect of removing $393 million in in non-operating expenses (3% of revenue). You can see all the adjustments made to Kirby Corporation's income statement here.

Balance Sheet: we made $792 million in adjustments to calculate invested capital with a net increase of $620 million. One of the largest adjustments was $626 million in asset write-downs. This adjustment represented 11% of reported net assets. You can see all the adjustments made to Kirby Corporation's balance sheet here.

Valuation: we made $2.3 billion in adjustments with a net effect of decreasing shareholder value by $2.3 billion. There were no adjustments that increased shareholder value. Apart from total debt, the most notable adjustment to shareholder value was $607 million in net deferred tax liabilities. This adjustment represents 15% of Kirby Corporation's market cap. See all adjustments to Kirby Corporation's valuation here.

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

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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