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

Recap From August's Picks

Our Most Attractive Stocks (+4.5%) outperformed the S&P 500 (+2.7%) from August 4, 2021 through August 31, 2021 by 1.8%. The best performing large cap stock gained 35% and the best performing small cap stock was up 28%. Overall, 21 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+2.4%) outperformed the S&P 500 (+2.7%) as a short portfolio from August 4, 2021 through August 31, 2021 by 0.3%. The best performing large cap stock fell by 16% and the best performing small cap stock fell by 13%. Overall, 19 out of the 34 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios outperformed as an equal-weighted long/short portfolio by 1.1%.

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.

16 new stocks make our Most Attractive list this month, and 13 new stocks fall onto the Most Dangerous list this month. September's Most Attractive and Most Dangerous stocks were made available to members on September 2, 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 September: Group 1 Automotive (GPI: $160/share)

Group 1 Automotive is the featured stock from September's Most Attractive Stocks Model Portfolio.

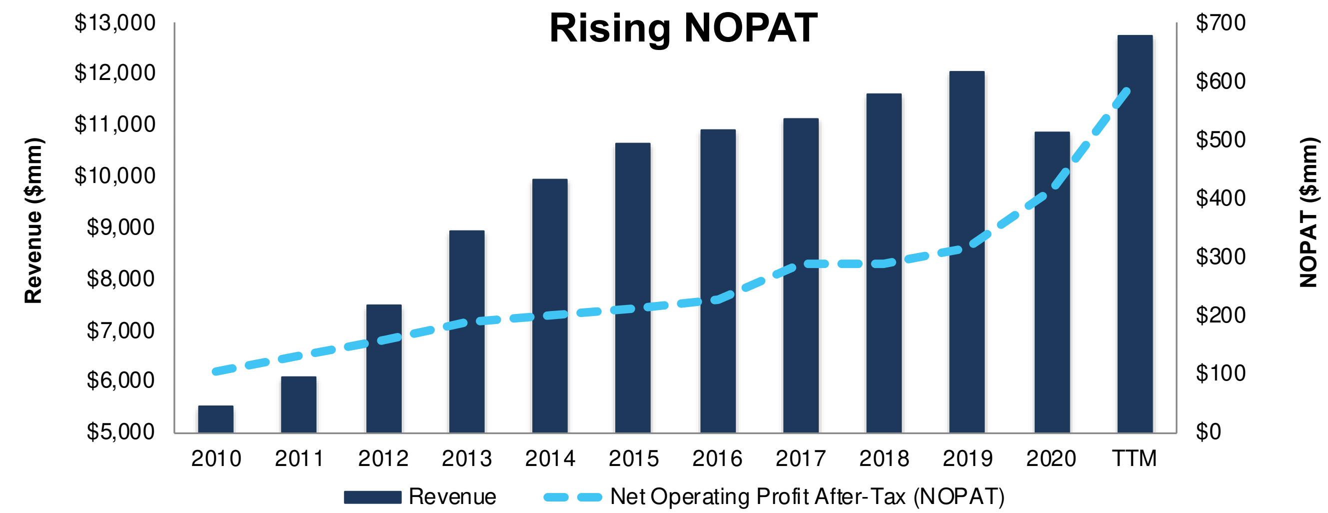
Group 1 Automotive has grown revenue by 7% compounded annually and net operating profit after-tax (NOPAT) by 15% compounded annually over the last decade.

The firm's NOPAT margin increased from 2% in 2010 to 5% over the trailing twelve months (TTM), while its invested capital turns increased from 2.3 to 2.6 over the same period. Rising margins and invested capital turns drive an improvement in Group 1 Automotive's ROIC from 4% in 2010 to 12% TTM.

Over the past five years, Group 1 Automotive generated $1.1 billion (38% of market cap) in cumulative free cash flow (FCF). Over the TTM, Group 1 Automotive has generated $710 million 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

GPI Is Undervalued

At its current price of $160/share, GPI has a price-to-economic book value (PEBV) ratio of 0.3. This ratio means the market expects Group 1 Automotive's NOPAT to permanently decline by 70%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 15% compounded annually over the past decade.

Even if Group 1 Automotive's NOPAT margin falls to 2% (10-year average, compared to 5% TTM) and the firm's NOPAT declines by 1% compounded annually for the next decade, the stock is worth $288/share today – an 80% upside. See the math behind this reverse DCF scenario. Should Group 1 Automotive 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 Group 1 Automotive's 10-K and 10-Qs:

Income Statement: we made $238 million of adjustments, with a net effect of removing $138 million in non-operating expenses (1% of revenue). You can see all the adjustments made to Group 1 Automotive's income statement here.

Balance Sheet: we made $2 billion in adjustments to calculate invested capital with a net increase of $1.9 billion. One of the most notable adjustments was $373 million in asset write downs. This adjustment represented 11% of reported net assets. You can see all the adjustments made to Group 1 Automotive's balance sheet here.

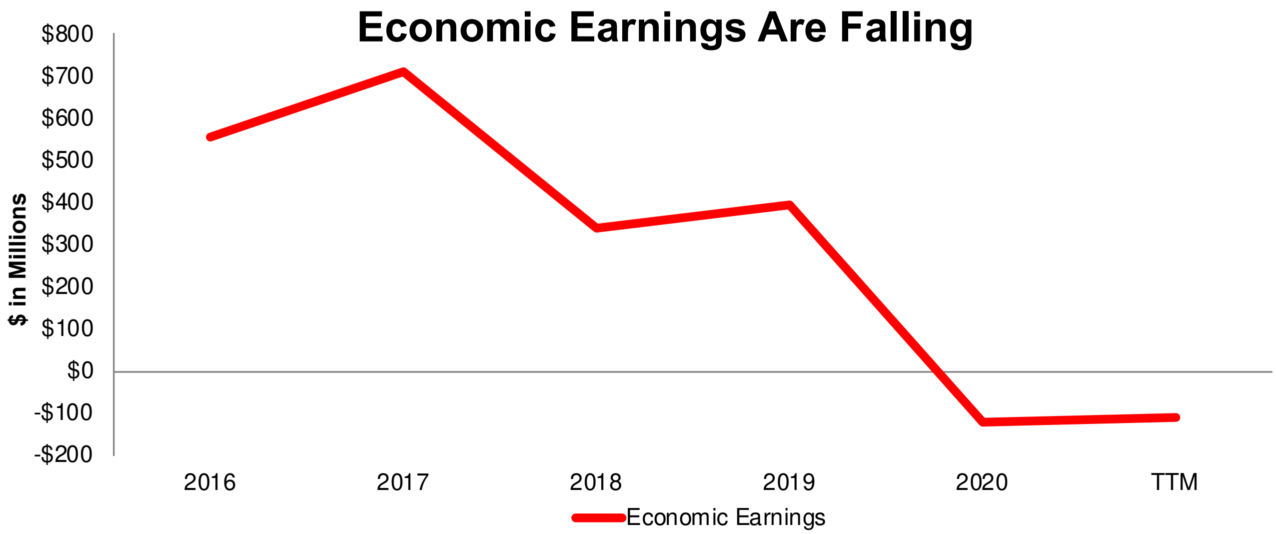
Valuation: we made $2.4 billion of adjustments, all of which decreased shareholder value. Apart from total debt, one of the most notable adjustments to shareholder value was $148 million in deferred tax liabilities. This adjustment represents 5% of Group 1 Automotive's market cap. See all adjustments to Group 1 Automotive's valuation here.

Most Dangerous Stocks Feature: Fortive Corp (FTV: $75/share)

Fortive Corp (FTV) is the featured stock from September's Most Dangerous Stocks Model Portfolio.

Fortive's economic earnings, the true cash flows of the business, fell from $554 million in 2016 to -$113 million over the TTM. The firm's NOPAT margin fell from 15% in 2016 to 14% TTM, while invested capital turns fell from 1.0 to 0.3 over the same time. Falling NOPAT margins and invested capital turns drive FTV's ROIC from 15% in 2016 to 4% TTM.

Figure 2: Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

FTV Provides Poor Risk/Reward

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

To justify its current price of $75/share, Fortive must improve its NOPAT margin to 15% (compared to 12% in 2020) and grow NOPAT by 12% compounded annually for the next decade. See the math behind this reverse DCF scenario. Given Fortive's NOPAT fell by 9% compounded annually over the past five years, we think these expectations are overly optimistic.

Even if Fortive can achieve a NOPAT margin of 15% and grow NOPAT by 7% compounded annually for the next decade, the stock is worth just $50/share today – a 33% downside to the current stock price. See the math behind this reverse DCF scenario. Should Fortive's NOPAT grow at a slower rate or, even worse, continue its downward trend, the stock has even more downside.

Each of these scenarios also assumes Fortive 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 Fortive's 10-K and 10-Qs:

Income Statement: we made $1.7 billion in adjustments, with a net effect of removing $991 million in in non-operating income (21% of revenue). You can see all the adjustments made to Fortive's income statement here.

Balance Sheet: we made $5.7 billion in adjustments to calculate invested capital with a net decrease of $139 million. One of the most notable adjustments was $141 million in other comprehensive income. This adjustment represented 1% of reported net assets. You can see all the adjustments made to Fortive's balance sheet here.

Valuation: we made $5.6 billion in adjustments with a net effect of decreasing shareholder value by $2.6 billion. Apart from total debt, the most notable adjustment to shareholder value was $1.5 billion in excess cash. This adjustment represents 6% of Fortive's market cap. See all adjustments to Fortive's valuation here.

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Disclosure: David Trainer, Kyle Guske II, Alex Sword, 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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