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

Recap From October's Picks

Our Most Attractive Stocks (+4.4%) underperformed the S&P 500 (+5.7%) from October 6, 2021 through November 1, 2021 by 1.3%. The best performing large cap stock gained 15% and the best performing small cap stock was up 16%. Overall, 16 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+1.3%) outperformed the S&P 500 (+5.7%) as a short portfolio from October 6, 2021 through November 1, 2021 by 4.4%. The best performing large cap stock fell by 13% and the best performing small cap stock fell by 18%. Overall, 28 out of the 37 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 1.6%.

Learn more about the best fundamental research

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research and provides investors with a new source of alpha. 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.

11 new stocks make our Most Attractive list this month, and nine new stocks fall onto the Most Dangerous list this month. November's Most Attractive and Most Dangerous stocks were made available to members on November 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 November: AutoNation Inc. (AN: $125/share)

AutoNation Inc. is the featured stock from November's Most Attractive Stocks Model Portfolio.

AutoNation has grown revenue by 5% compounded annually and net operating profit after-tax (NOPAT) by 8% compounded annually over the past decade.

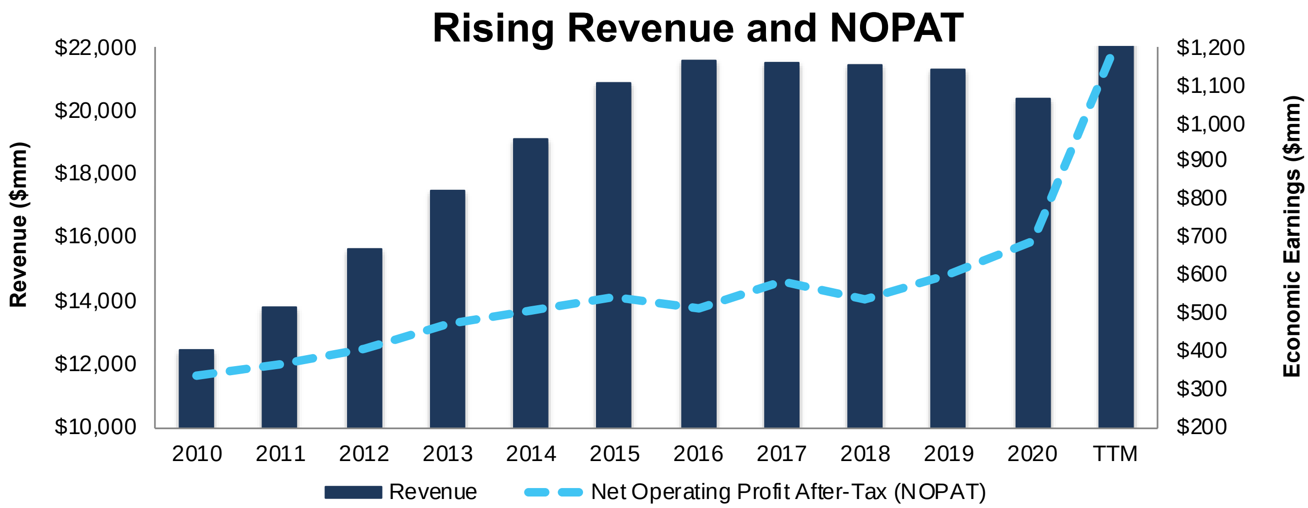
The company's NOPAT margin increased from 3% in 2010 to 5% over the trailing twelve months (TTM), while invested capital turns rose from 1.6 to 2.4 over the same period. Rising margins and improved invested capital turns drive AutoNation's ROIC from 4% in 2010 to 12% TTM.

Over the past five years, AutoNation generated $2.7 billion (33% of market cap) in cumulative free cash flow (FCF). Over the TTM, AutoNation has generated $2.8 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.

Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.

Figure 1: Revenue & NOPAT Since 2010



Sources: New Constructs, LLC and company filings

AN Is Undervalued

At its current price of $125/share, AN has a price-to-economic book value (PEBV) ratio of 0.3. This ratio means the market expects AutoNation's NOPAT to permanently decline by 70%. This expectation seems overly pessimistic for a company that has grown NOPAT by 5% compounded annually over the past five years.

Even if AutoNation's NOPAT margin falls to 3% (equal to five-year average, compared to 5% TTM) and the company's NOPAT grows by just 1% compounded annually for the next decade, the stock is worth $181/share today – a 45% upside. See the math behind this reverse DCF scenario. Should AutoNation grow profits more 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 AutoNation's 10-K and 10-Qs:

Income Statement: we made $844 million in adjustments, with a net effect of removing $310 million in non-operating expenses (<1% of revenue). You can see all the adjustments made to AutoNation's income statement here.

Balance Sheet: we made $5.8 billion in adjustments to calculate invested capital with a net increase of $5.8 billion. One of the most notable adjustments was $2.2 billion in asset write-downs. This adjustment represented 10% of reported net assets. You can see all the adjustments made to AutoNation's balance sheet here.

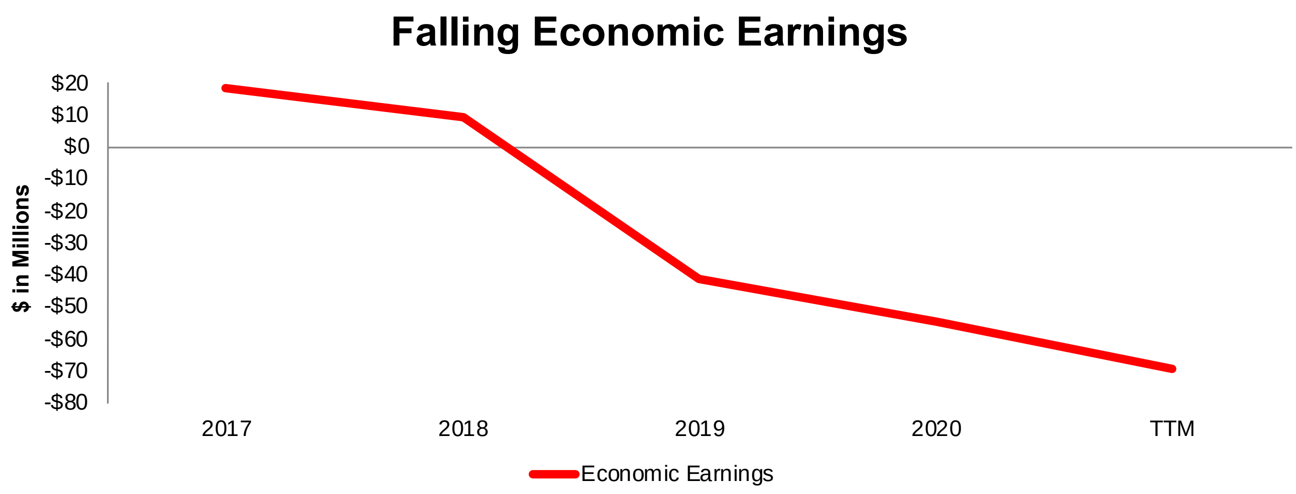
Valuation: we made $4.7 billion of adjustments to shareholder value, all of which decreased shareholder value. Apart from total debt, one of the most notable adjustments to shareholder value was $100 million in net deferred compensation. This adjustment represents 1% of AutoNation's market cap. See all adjustments to AutoNation's valuation here.

Most Dangerous Stocks Feature: Silicon Laboratories (SLAB: $202/share)

Silicon Laboratories Inc. (SLAB) is the featured stock from November's Most Dangerous Stocks Model Portfolio.

Silicon Laboratories' economic earnings, the true cash flows of the business, fell from $18 million in 2017 to -$69 million over the TTM. The company's NOPAT margin fell from 10% in 2017 to 2% TTM, while invested capital turns fell from 1.1 to 0.7 over the same time. Falling NOPAT margins and invested capital turns drive Silicon Laboratories' ROIC from 11% in 2017 to 2% TTM.

Figure 2: Economic Earnings Since 2017



Sources: New Constructs, LLC and company filings

SLAB Provides Poor Risk/Reward

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

To justify its current price of $202/share, Silicon Laboratories must improve its NOPAT margin to 11% (five-year high compared to 2% TTM) and grow NOPAT by 33% compounded annually for the next decade. See the math behind this reverse DCF scenario. Given that Silicon Laboratories' NOPAT fell 7% compounded annually over the past decade, we think these expectations are overly optimistic.

Even if Silicon Laboratories can achieve a NOPAT margin of 5% (three-year high) and grow NOPAT by 13% compounded annually for the next decade, the stock is worth just $81/share today – a 60% downside to the current stock price. See the math behind this reverse DCF scenario. Should Silicon Laboratories' 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 Silicon Laboratories 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 Silicon Laboratories' 10-K and 10-Qs:

Income Statement: we made $55 million in adjustments, with a net effect of removing $19 million in in non-operating expenses (2% of revenue). You can see all the adjustments made to Silicon Laboratories' income statement here.

Balance Sheet: we made $983 million in adjustments to calculate invested capital with a net decrease of $593 million. One of the most notable adjustments was $104 million in midyear acquisitions. This adjustment represented 6% of reported net assets. You can see all the adjustments made to Silicon Laboratories' balance sheet here.

Valuation: we made $3.3 billion in adjustments with a net effect of increasing shareholder value by $2 billion. The most notable adjustment to shareholder value was $2.7 billion in excess cash. This adjustment represents 35% of Silicon Laboratories' market cap. See all adjustments to Silicon Laboratories' 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.

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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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