Position Close Update: Change Healthcare (CHNG)

Change Healthcare (CHNG: $23/share) – Closing Long Position – up 67% vs. S&P up 30%

We featured Change Healthcare's Attractive rating in June 2019, right before the company went public. Unlike other IPOs at the time, the company generated consistent profits and had an undervalued expected IPO valuation. Since then, the firm's fundamentals have been deteriorating, so we are closing our long position in CHNG.

This report leverages our cutting-edge Robo-Analyst technology to deliver proven-superior[1] fundamental research and support more cost-effective fulfillment of the fiduciary duty of care.

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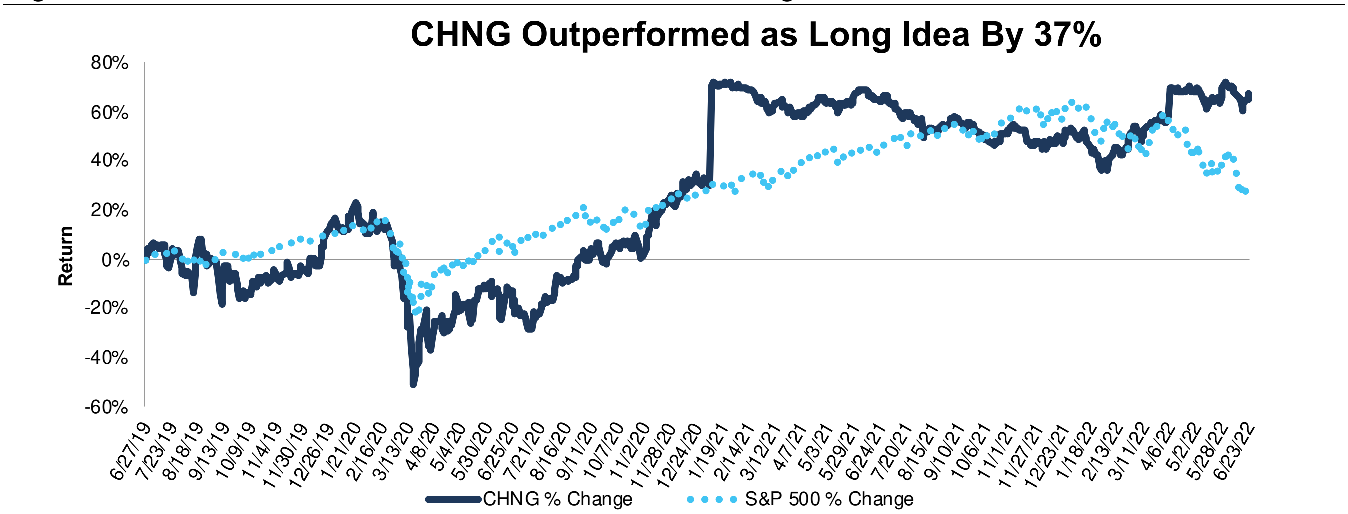
During the three-year holding period, CHNG outperformed as a long position, rising 67% compared to a 30% gain for the S&P 500.

Since going public, Change Healthcare's fundamentals have deteriorated. It's return on invested capital (ROIC) fell from 11% in fiscal 2018 (FYE is 3/31) to 2% over the trailing-twelve-months (TTM) while net operating profit after-tax (NOPAT) margin fell from 18% to 5% over the same time.

However, in January 2021, Optum, a part of United Health Group (UNH), agreed to acquire Change Healthcare for ~$26/share. The deal has received significant scrutiny with the Department of Justice (DOJ) first looking into the acquisition in March 2021. DOJ resistance caused the companies to extend the acquisition agreement deadline in December 2021 and again in April 2022.

The DOJ sued to block the acquisition in February 2022, and a trial is set for August 2022. Shares trade slightly below the proposed deal price, indicating investors aren't convinced the companies will prevail in their legal arguments. With the stock up 67% since its IPO price, we think now is the time to close this winning Long Idea.

Figure 1: CHNG vs. S&P 500 – Price Return – Successful Long Idea



Sources: New Constructs, LLC and company filings
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

This article originally published on June 24, 2022.

[1] Our research utilizes our Core Earnings, a more reliable measure of profits, as proven in Core Earnings: New Data & Evidence, written by professors at Harvard Business School (HBS) & MIT Sloan and published in The Journal of Financial Economics.

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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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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