Zombie Stocks That Could Go to $0: The Full List

The 13 stocks we put on our Zombie Stocks list (-13%) have outperformed the S&P 500 (+3%) by 16% as a short portfolio since inception of the list. This report details the performance of each Zombie Stock and adds a new stock to the list.

Zombie Stocks Outperform as Shorts

Nine of the 13 companies we've already featured as Zombie Stocks have outperformed the S&P 500 as shorts since each respective report was published. Seven Zombie Stocks, AMC Entertainment (AME), Freshpet Inc. (FRPT), GameStop Corporation (GME), Beyond Meat (BYND), Chewy Inc. (CHWY), DoorDash (DASH), and Peloton (PTON),have outperformed as shorts by more than 20%. See Figure 1.

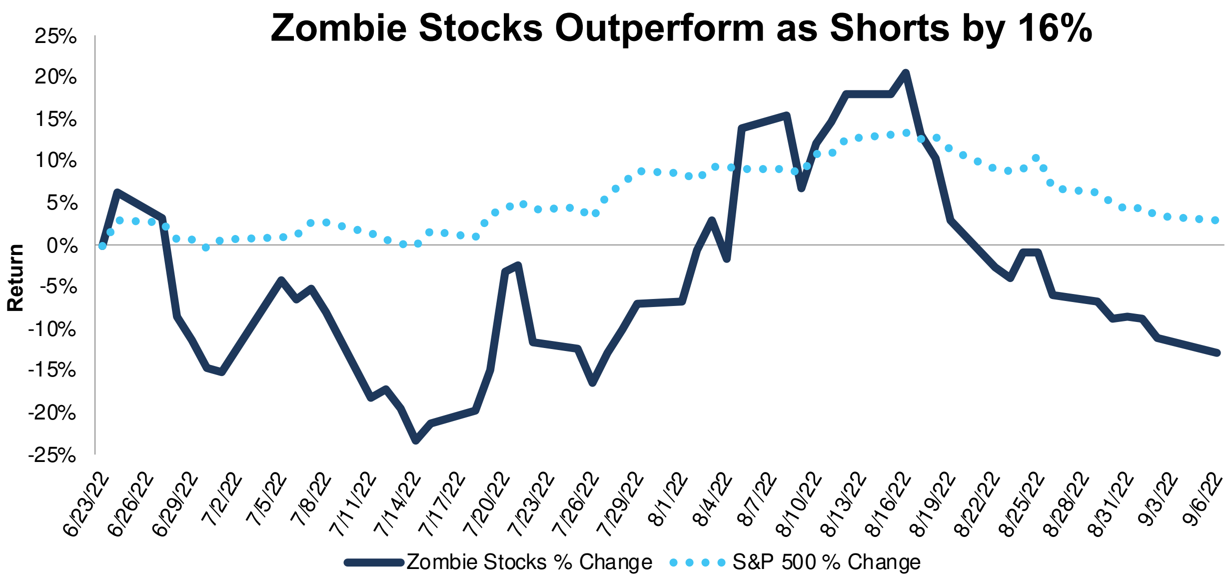
Figure 1: Performance of Zombie Stocks Since Zombie Report Published Through 9/6/22

Company Name	Ticker	Publish Date	Return Vs. S&P 500
AMC Entertainment	AMC	8/15/22	37%*
Freshpet Inc.	FRPT	6/23/22	32%
GameStop Corporation	GME	8/15/22	28%
Beyond Meat, Inc.	BYND	8/1/22	27%
Chewy Inc.	CHWY	8/17/22	23%
DoorDash, Inc.	DASH	8/10/22	21%
Peloton Interactive	PTON	6/23/22	20%
Rivian Automotive	RIVN	8/8/22	7%
Shake Shack, Inc.	SHAK	8/10/22	4%
Uber Technologies	UBER	8/17/22	-3%
Carvana Co.	CVNA	6/23/22	-7%
Snap Inc.	SNAP	7/22/22	-9%
Robinhood Markets	HOOD	8/22/22	-11%
Tilray Brands	TLRY	9/7/22	N/A**

Sources: New Constructs, LLC and company filings.
AMC performance tracks the performance of AMC and AMC's preferred equity shares (APE), the latter of which began trading on 8/22/22.
**TLRY is added to the Zombie Stock list in this report. Date is the publish date of this report.

Since our first report on June 23, 2022, the Zombie Stocks have fallen 13% while the S&P 500 is up 3% over the same time. See Figure 2.

Figure 2: Combined Performance of Zombie Stocks Through 9/6/22



Sources: New Constructs, LLC and company filings.

What Makes a Zombie Stock?

Zombie Stocks are those that have:

- a negative interest coverage ratio (EBIT/interest expense)
- negative free cash flow (FCF) over the TTM or negative 2-year average FCF over the TTM
- less than 24 months of cash on hand

Companies with heavy cash burn, little cash on hand, and the inability to cover interest payments from operating earnings, are risky investments in any market, but especially now as liquidity has all but dried up in 2022[1]. When the cash runs out these companies will turn to the equity market and dilute existing shareholders.

Expensive valuations make Zombie Stocks even more risky. Stock valuations that embed unrealistic expectations for high levels of long-term profit growth add more risk to owning shares of zombie stocks facing short-term distress.

For these reasons, along with the competitive challenges outlined in each report linked in Figure 1, we do not think equity investors in these companies will see $1 of economic earnings. As a result, these stocks are worth $0 today and have been for some time.

Adding Tilray Brands (TLRY) to the Zombie Stock List

We published an update on Tilray, the last stock listed in Figure 1, in July 2022 just before we launched the Zombie Stocks list. Otherwise, we would've added the stock to the list then. Since our July 2022 report, Tilray's stock has outperformed as a short vs. the S&P 500 by 3%. Since we first warned on Tilray in July 2018, the stock has outperformed as a short by 124%.

Reverse DCF Math: Tilray's Shares Have 70%+ More Downside

Below we use our reverse discounted cash flow (DCF) model to analyze the future cash flow expectations baked into Tilray's stock price. We also provide an additional scenario to highlight the downside potential in shares if Tilray's revenue grows at more reasonable rates.

To justify its current price of $3.50/share, our model shows that Tilray would have to:

[1] As Brian Pellegrini of Intertemporal Economics notes in a recent research note.

- improve its net operating profit after-tax (NOPAT) margin to 10% (more than double the 4% margin of farming companies under coverage[2], compared to Tilray's -16% margin in fiscal 2022),
- grow revenue at consensus rates in fiscal 2023 and 2024, and
- grow revenue by 17% each year thereafter through fiscal 2032.

In this scenario, Tilray would generate $2.7 billion in revenue in fiscal 2032, which is 4x its fiscal 2022 revenue and nearly 7x its fiscal 2020 revenue. We think it is overly optimistic to assume Tilray will grow revenue by 16% compounded annually over the next decade while achieving NOPAT margins more than twice the traditional farming industry. In a more realistic scenario, detailed below, the stock has large downside risk.

TLRY Has 70%+ Downside if Consensus Is Right

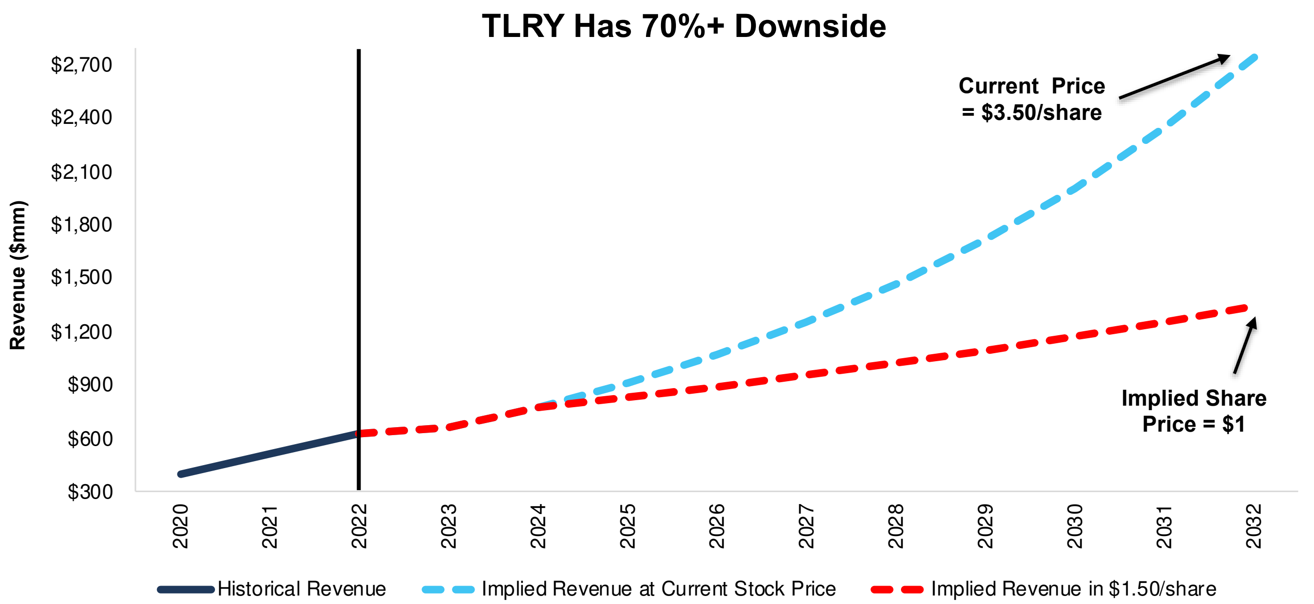
Even if we assume Tilray:

- improves NOPAT margin to -5% in fiscal 2023, 0% in fiscal 2024, 5% in fiscal 2025, and 10% from fiscal 2026 – 2032,
- revenue grows at consensus rates in fiscal 2023 and 2024, and
- revenue grows 7% a year in fiscal 2025-2032, then

the stock would be worth just $1/share today – a 71% downside to the current price. This scenario still implies Tilray's revenue grows to $1.3 billion in fiscal 2032, all while the company drastically improves its margin. If Tilray fails to achieve the revenue growth or margin improvement we assume for this scenario, the downside risk in the stock would be even higher.

Figure 3 compares Tilray's historical revenue to the revenue implied by each of the above DCF scenarios.

Figure 3: Tilray's Historical and Implied Revenue: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings.
Dates represent Tilray's fiscal year, which runs through May of each year

Stock is Not Even Worth $1

Each of the above scenarios also assumes Tilray grows revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is highly unlikely but allows us to create best-case scenarios that demonstrate the unusually high expectations embedded in the current valuation. For reference, Tilray's invested capital increased from $1.4 billion in fiscal 2020 to $5.6 billion in fiscal 2022, or 98% compounded annually.

[2] Farming companies include Alico (ALCO), Cal-Maine Foods (CALM), Corteva (CTVA), Fresh Del Monte Produce (FDP), Limoneira Company (LMNR), Phibro Animal Health Corp (PAHC), SiteOne Landscape Supply (SITE), and The Andersons (ANDE).

Given that the performance required to justify its current price and even $1/share look overly optimistic, we dig deeper to see if this stock is worth buying at any price. The answer is no.

The company owes $623 million in total debt, has $197 million worth of deferred tax liabilities, $43 million in minority interests, $3 million in outstanding employee stock options, and holds just $269 million in excess cash. With a high cash burn rate, the likelihood of needing additional capital and further diluting common equity shareholders is high. It is highly unlikely that the company will ever make enough money to satisfy stakeholders with higher claims on the company's cash flows than common equity shareholders. Not surprisingly, TLRY has an economic book value, or no growth value, of -$3/share. In other words, we do not think equity investors will ever see $1 of economic earnings, which means the stock is worth $0 today.

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

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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.

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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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