



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

16 new stocks made our Most Attractive list this month, while 18 new stocks joined the Most Dangerous list. We published September's Most Attractive and Most Dangerous stocks to members on September 7, 2023.

### August Performance Recap

Our Most Attractive Stocks (-2.5%) underperformed the S&P 500 (-0.1%) last month by 2.4%. The best performing large cap stock gained 9% and the best performing small cap stock was up 20%. Overall, 15 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-4.7%) outperformed the S&P 500 (-0.1%) as a short portfolio last month by 4.6%. The best performing large cap short stock fell by 13% and the best performing small cap short stock fell by 51%. Overall, 18 out of the 29 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 2.2%.

[Buy the Most Attractive Stocks Model Portfolio](#)

[Buy the Most Dangerous Stocks Model Portfolio](#)

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

All of our Most Attractive stocks have high (and rising) return on invested capital ([ROIC](#)) and low [price to economic book value ratio](#). Most Dangerous stocks have [misleading earnings](#) and long [growth appreciation periods](#) implied by their market valuations.

### Most Attractive Stocks Feature for September: Allison Transmission Holdings (ALSN)

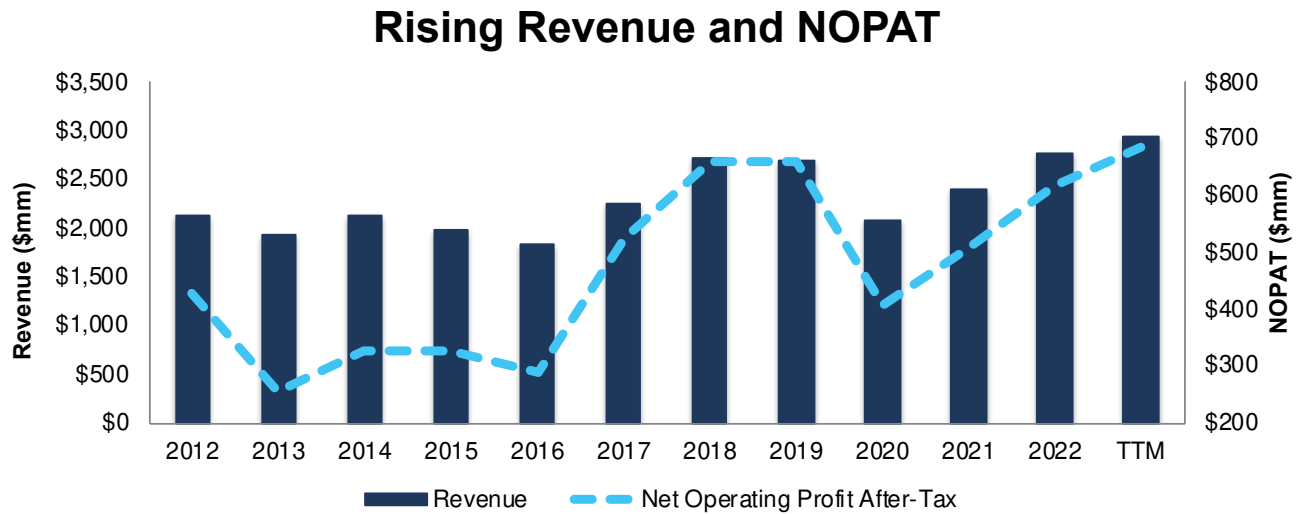
Allison Transmission Holdings (ALSN: \$59/share) is the featured stock from September's [Most Attractive Stocks Model Portfolio](#). We first made Allison Transmission a [Long Idea](#) in [June 2020](#) and the stock remains undervalued.

Allison Transmission has grown revenue by 3% compounded annually and net operating profit after tax ([NOPAT](#)) by 5% compounded annually since 2012. Allison Transmission's NOPAT margin increased from 20% in 2012 to 23% in the trailing twelve months (TTM), and [invested capital turns](#) rose from 0.5 to 0.7 over the same time. Rising NOPAT margins and invested capital turns drive Allison Transmission's return on invested capital ([ROIC](#)) from 10% in 2012 to 17% in the TTM.

<sup>1</sup> 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](#).



**Figure 1: Allison Transmission’s Revenue and NOPAT Since 2012**



Sources: New Constructs, LLC and company filings

### Allison Transmission Is Undervalued

At its current price of \$59/share, ALSN has a price-to-economic book value ([PEBV](#)) ratio of 0.6. This ratio means the market expects Allison Transmission’s NOPAT to permanently decline by 40%. This expectation seems overly pessimistic for a company that has grown NOPAT by 5% compounded annually since 2012.

Even if Allison Transmission’s NOPAT margin falls to 22% (equal to the five-year average compared to 23% over the TTM) and the company’s revenue grows just 2% compounded annually through 2032, the stock would be worth [\\$97/share today](#) – a 64% upside. Should Allison Transmission 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](#)

Below are specifics on the adjustments we made based on Robo-Analyst findings in Allison Transmission’s 10-Qs and 10-Ks:

**Income Statement:** we made \$227 million in adjustments, with a net effect of removing \$87 million in [non-operating expenses](#) (3% of revenue). Clients can see all adjustments made to Allison Transmission’s income statement on the GAAP Reconciliation tab on the Ratings page on our website.

**Balance Sheet:** we made \$1.5 billion in adjustments to calculate invested capital with a net decrease of \$86 million. One of the most notable adjustments was \$1.1 billion in adjustments for [deferred tax assets](#). This adjustment represents 25% of reported net assets. Clients can see all adjustments made to Allison Transmission’s balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

**Valuation:** we made \$3.2 billion in adjustments, with a net decrease in shareholder value of \$2.6 billion. The most notable adjustment was \$2.3 billion in [total debt](#). This adjustment represents 44% of Allison Transmission’s market value. Clients can see all adjustments to Allison Transmission’s valuation on the GAAP Reconciliation tab on the Ratings page on our website.

### Most Dangerous Stocks Feature: Schrodinger Inc. (SDGR)

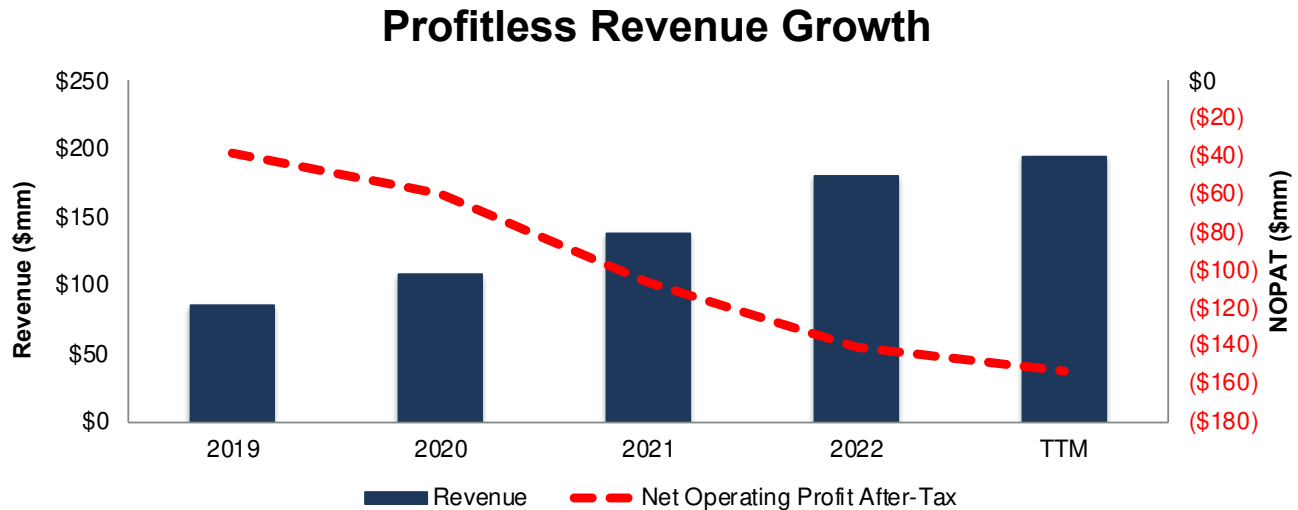
Schrodinger Inc. (SDGR: \$34/share) is the featured stock from September’s [Most Dangerous Stocks Model Portfolio](#).

Schrodinger has grown revenue 26% compounded annually since 2019 while its NOPAT has fallen from -\$38 million in 2019 to -\$153 million over the TTM. See Figure 2. NOPAT margin has fallen from -44% in 2019 to -79% in the TTM and the company currently generates a -23% ROIC.



Schrodinger's [economic earnings](#), the true cash flows of the business which take into account changes to the balance sheet, have fallen from -\$48 million in 2019 to -\$232 million over the TTM.

**Figure 2: Schrodinger's Revenue and NOPAT Since 2019**



Sources: New Constructs, LLC and company filings

### SDGR Provides Poor Risk/Reward

Despite its poor fundamentals, Schrodinger's stock is priced for significant profit growth, and we believe the stock is overvalued.

To justify its current price of \$34/share, Schrodinger must improve its NOPAT margin to 15% (up from -79% over the TTM) and grow revenue by 34% compounded annually through 2032. In this [scenario](#), Schrodinger's NOPAT would equal \$507 million in 2032, up from its best ever NOPAT of -\$38 million. We think these expectations are overly optimistic.

Even if Schrodinger improves its NOPAT margin to 15% and grows revenue 26% compounded annually through 2032, the stock would be worth no more than [\\$18/share today](#) – a 47% downside to the current stock price.

Each of these scenarios also assumes Schrodinger's can 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 the high expectations embedded in the current valuation.

### Critical Details Found in Financial Filings by Our [Robo-Analyst Technology](#)

Below are specifics on the adjustments we made based on Robo-Analyst findings in Schrodinger's 10-Qs and 10-K:

**Income Statement:** we made \$40 million in adjustments, with a net effect of removing \$8 million in [non-operating expenses](#) (4% of revenue). Clients can see all adjustments made to Schrodinger's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

**Balance Sheet:** we made \$57 million in adjustments to calculate invested capital with a net increase of \$56 million. One of the most notable adjustments was \$19 million in [operating leases](#). This adjustment represented 3% of reported net assets. Clients can see all adjustments made to Schrodinger's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

**Valuation:** we made \$322 million in adjustments, all of which decreased shareholder value. The most notable adjustment to shareholder value was \$181 million in [outstanding employee stock options](#). This adjustment represents 9% of Schrodinger's market value. Clients can see all adjustments to Schrodinger's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

*This article was originally published on [September 14, 2023](#).*



*Disclosure: David Trainer, Kyle Guske II, Hakan Salt, and Italo Mendonça receive no compensation to write about any specific stock, style, or theme.*

*Questions on this report or others? Join our [Society of Intelligent Investors](#) and connect with us directly.*



## *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, 1<sup>st</sup> 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, 2<sup>nd</sup> 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, 5<sup>th</sup> 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, 2<sup>nd</sup> 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, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> 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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