New Stocks on Most Attractive/Most Dangerous: April 2017

Recap from March Picks

Our Most Attractive Stocks (+0.6%) outperformed the S&P 500 (-1.0%) last month. Most Attractive Large Cap stock Lam Research Corp (LRCX) gained 8%. Most Attractive Small Cap stock Maui Land & Pineapple (MLP) was up 30%. Overall, 17 out of the 40 Most Attractive stocks outperformed the S&P 500 in March.

Our Most Dangerous Stocks (-2.2%) outperformed the S&P 500 (-1.0%) last month. Most Dangerous Large Cap stock Vornado Realty Trust (VNO) fell by 7% and Most Dangerous Small Cap Stock IDT Corporation (IDT) fell by 38%. Overall, 13 out of the 40 Most Dangerous stocks outperformed the S&P 500 in March and 15 had negative returns.

The successes of the Most Attractive and Most Dangerous stocks highlight the value of our robo-analyst technology, which helps clients fulfill the fiduciary duty of care when making investment recommendations.

15 new stocks make our Most Attractive list this month and 27 new stocks fall onto the Most Dangerous list this month. April's Most Attractive and Most Dangerous stocks were made available to members on 4/5/17.

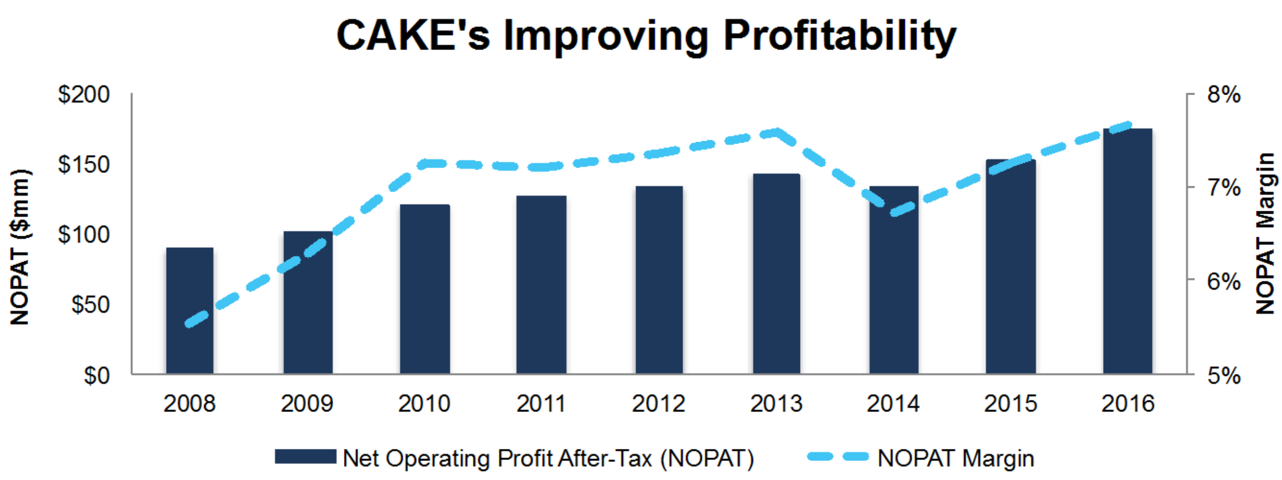
Our Most Attractive stocks have high and rising returns on invested capital (ROIC) and low price to economic book value ratios. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

Most Attractive Stocks Feature for April: The Cheesecake Factory (CAKE: $63/share)

The Cheesecake Factory (CAKE) is one of the additions to our Most Attractive stocks for April.

Since 2008, Cheesecake Factory has grown after-tax profit (NOPAT) by 9% compounded annually. Per Figure 1, Cheesecake Factory has also improved its NOPAT margin from 6% in 2008 to 8% in 2016.

Figure 1: Cheesecake Factory's Improving NOPAT Since 2008



Sources: New Constructs, LLC and company filings

Cheesecake Factory currently earns an 11% return on invested capital (ROIC), which is up from 6% in 2008. Furthermore, Cheesecake Factory has generated a cumulative $564 million (19% of market cap) in free cash flow over the past five years.

CAKE Valuation Holds Significant Upside Potential

The market has rewarded CAKE for its consistent profit growth and the stock is up 21% over the past year while the S&P is up just 14%. However, CAKE remains undervalued. At its current price of $63/share, Cheesecake

Factory has a price-to-economic book value (PEBV) ratio of 1.1. This ratio means the market expects Cheesecake Factory's profits to grow by no more than 10% over the remainder of its corporate life. This expectation seems rather pessimistic for a company that has grown NOPAT by 9% compounded annually since 2008.

If Cheesecake Factory can maintain 2016 NOPAT margins (8%) and grow NOPAT by just 6% compounded annually for the next decade, the stock is worth $88/share today – a 40% upside.

Impacts of Footnotes Adjustments and Forensic Accounting

Our robo-analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill the fiduciary duty of care. In order to derive the true recurring cash flows, an accurate invested capital, and an accurate shareholder value, we made the following adjustments to The Cheesecake Factory's 2016 10-K:

Income Statement: we made $59 million of adjustments, with a net effect of removing $35 million in non-operating expense (2% of revenue). We removed $12 million in non-operating income and $47 million in non-operating expenses. You can see all the adjustments made to CAKE's income statement here.

Balance Sheet: we made $831 million of adjustments to calculate invested capital with a net increase of $733 million. One of the largest adjustments was $745 million due to operating leases. This adjustment represented 81% of reported net assets. You can see all the adjustments made to CAKE's balance sheet here.

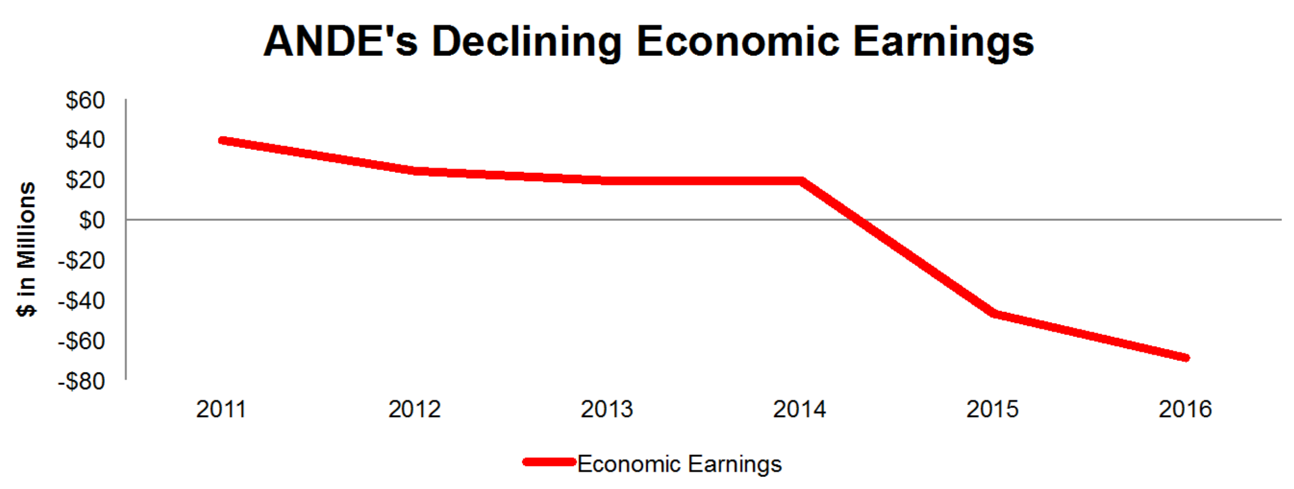
Valuation: we made $962 million of adjustments with a net effect of decreasing shareholder value by $962 million. There were no adjustments that increased shareholder value. Apart from total debt, which includes the $745 million in operating leases noted above, the largest adjustment to shareholder value was $82 million in net deferred tax liabilities. This adjustment represents 3% of CAKE's market cap. Despite decreasing shareholder value, CAKE remains undervalued.

Most Dangerous Stocks Feature: The Andersons, Inc. (ANDE: $38/share)

The Anderson's (ANDE) is one of the additions to our Most Dangerous stocks for April.

The Andersons' economic earnings, the true cash flows of the business, have declined from $39 million in 2011 to -$69 million in 2016, per Figure 1. The firm's NOPAT margins fell from 2% to below 1% over the same time.

Figure 2: The Andersons' Deteriorating Economic Earnings



Sources: New Constructs, LLC and company filings

The Andersons' ROIC has fallen from 9% in 2011 to a bottom-quintile 2% in 2016. Worse yet, The Anderson's burned through $69 million (7% of market cap) in FCF in 2016 and a cumulative $11 million (1% of market cap) in FCF over the past five years.

ANDE Is Priced to Perfection

ANDE is up 22% over the past year while the S&P is up just 14%. This price appreciation amidst deteriorating fundamentals makes ANDE significantly overvalued. To justify its current price of $38/share, ANDE must grow NOPAT by 13% compounded annually for the next 11 years. This scenario seems overly optimistic given The Andersons' NOPAT has declined by 22% compounded annually since 2011.

Even if ANDE can grow NOPAT at a more reasonable, yet still optimistic, 8% compounded annually for the next decade, the stock is worth $13/share today – a 66% downside.

Each of these scenarios assumes The Anderson's is able to grow revenue and NOPAT/free cash flow without spending on working capital or fixed assets. This assumption is unlikely but allows us to create very optimistic scenarios that demonstrate how high expectations in the current valuation are. For reference ANDE's invested capital has grown on average $101 million (3% of 2016 revenue) per year over the last five years.

Impacts of Footnotes Adjustments and Forensic Accounting

Our robo-analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill the fiduciary duty of care. In order to derive the true recurring cash flows, an accurate invested capital, and an accurate shareholder value, we made the following adjustments to The Andersons' 2016 10-K:

Income Statement: we made $74 million of adjustments, with a net effect of removing $20 million in non-operating expense (1% of revenue). We removed $27 million in non-operating income and $47 million in non-operating expenses. You can see all the adjustments made to ANDE's income statement here.

Balance Sheet: we made $251 million of adjustments to calculate invested capital with a net increase of $241 million. One of the largest adjustments was $104 million due to asset write-downs. This adjustment represented 7% of reported net assets. You can see all the adjustments made to ANDE's balance sheet here.

Valuation: we made $768 million of adjustments with a net effect of decreasing shareholder value by $768 million. There were no adjustments that increased shareholder value. One of the largest adjustments to shareholder value was $182 million in deferred tax liabilities. This adjustment represents 17% of ANDE's market cap.

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

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How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensic accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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