



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

18 new stocks make our Most Attractive list this month, and 17 new stocks fall onto the Most Dangerous list this month. April's Most Attractive and Most Dangerous stocks were made available to members on April 3, 2019.

Get the best fundamental research

The successes of these model portfolios highlight the value of our machine learning and AI [Robo-Analyst technology](#)¹, which helps clients fulfill the [fiduciary duty of care](#) and make smarter investments².

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.

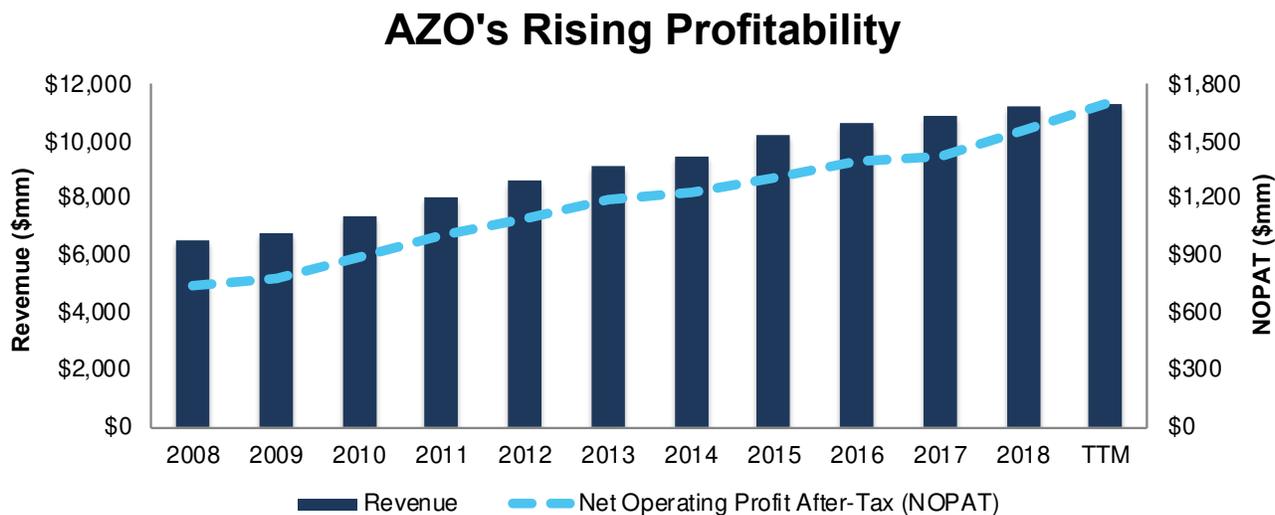
Most Attractive Stocks Feature for April: AutoZone Inc. (AZO: \$1,055/share)

AutoZone Inc. (AZO) is the featured stock from April's [Most Attractive Stocks Model Portfolio](#).

We made AutoZone a [Long Idea](#) in [February 2014](#) and we noted its exceptional corporate governance should lead to shareholder value creation. Since then, the stock is up 97% while the S&P 500 is up 57%.

From 2008 to 2018, AZO grew after-tax profit (NOPAT) by 8% compounded annually and revenue by 6% compounded annually. AZO's trailing twelve months (TTM) NOPAT has grown by 22% over the prior TTM period. AZO's ROIC has improved from 19% in 2008 to 26% TTM while the firm's NOPAT margin increased from 11% to 15% over the same time.

Figure 1: AZO's Revenue & NOPAT Since 2008



Sources: New Constructs, LLC and company filings

¹ Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

² Ernst & Young's recent white paper "[Getting ROIC Right](#)" demonstrates the superiority of our stock research and analytics.



AZO Valuation Provides Significant Upside

Although AZO is up over 70% over the past year, the stock still remains undervalued. At its current price of \$1,055/share, AZO has a price-to-economic book value ([PEBV](#)) ratio of 0.9. This ratio means the market expects AZO's NOPAT to permanently decline by 10%. This expectation seems rather pessimistic for a company that has grown NOPAT by 8% compounded annually over the past decade.

If AZO can maintain TTM NOPAT margins (15%) and grow NOPAT by just 5% compounded annually for the next ten years, the stock is worth \$1,583/share today – a 50% upside. [See the math behind this dynamic DCF scenario.](#)

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

As investors [focus more](#) on fundamental research, research automation technology is needed to analyze all the critical financial [details in financial filings](#). Below are specifics on the adjustments we make based on Robo-Analyst findings in AutoZone Inc.'s 2018 10-K:

Income Statement: we made \$1 billion of adjustments, with a net effect of removing \$215 million in [non-operating expenses](#) (2% of revenue). You can see all the adjustments made to AZO's income statement [here](#).

Balance Sheet: we made \$2.3 billion of adjustments to calculate invested capital with a net increase of \$2.3 billion. One of the largest adjustments was \$1.7 billion in off-balance sheet [operating leases](#). This adjustment represented 40% of reported net assets. You can see all the adjustments made to AZO's balance sheet [here](#).

Valuation: we made \$7.7 billion of adjustments, all of which decreased shareholder value. Apart from [total debt](#), which includes the operating leases noted above, the largest adjustment to shareholder value was \$638 million in outstanding [employee stock options](#). This adjustment represents 2% of AZO's market cap. See all adjustments to AZO's valuation [here](#).

Most Dangerous Stocks Feature: ACI Worldwide (ACIW: \$34/share)

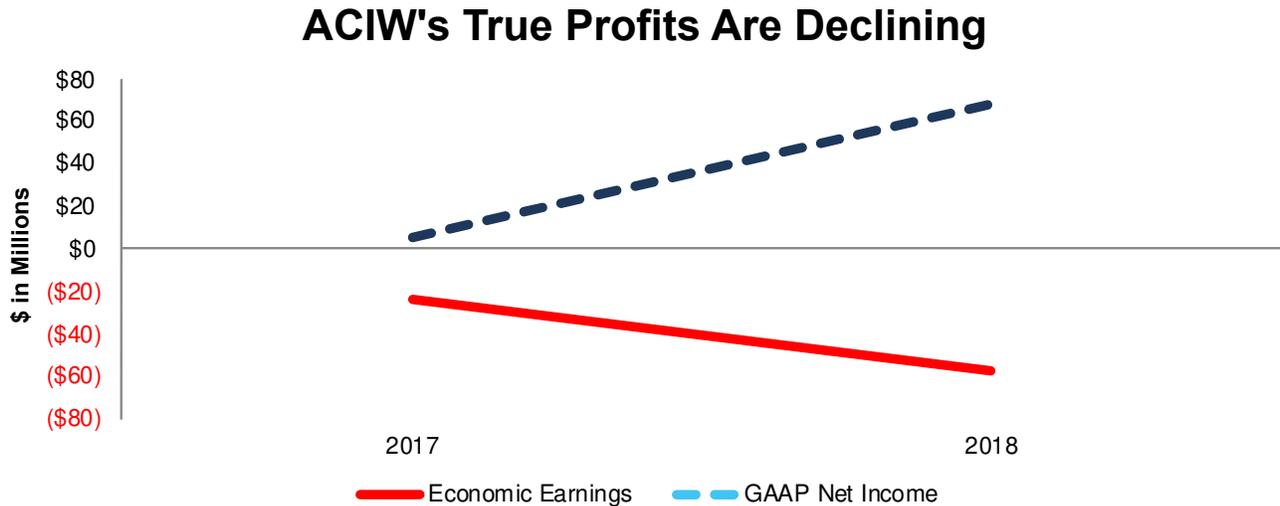
ACI Worldwide (ACIW) is the featured stock from April's [Most Dangerous Stocks Model Portfolio](#).

We made ACI Worldwide a [Danger Zone](#) pick in [June 2016](#). Since then, ACIW is up 65% while the S&P is up 38%. However, the fundamentals of the company have worsened and the shares are now even more overvalued.

Investors who look at GAAP net income would think that the company's profits recovered last year. GAAP net income increased from \$5 million in 2017 to \$69 million in 2018. However, [economic earnings](#), which measure the true cash flows of the business, decreased from -\$24 million to -\$57 million over this same period.



Figure 2: ACIW Economic Earnings & GAAP Net Income Year-over-Year



Sources: New Constructs, LLC and company filings

ACIW Provides Poor Risk/Reward

We believe ACIW rising 25% this year, despite the firm’s deteriorating fundamentals, means [noise traders](#) are buying into the company’s reported profit growth and not digging deeper. When we do so, we find that ACIW remains significantly overvalued.

To justify its current price of \$34/share, ACIW must improve its NOPAT margin to 17% (compared to 10% in 2018) and grow NOPAT by 18% compounded annually for 12 years. [See the math behind this dynamic DCF scenario](#). This expectation seems unrealistic given that ACIW’s NOPAT has declined by 3% compounded annually since 2014.

Even if ACIW can maintain 2018 NOPAT margins (10%) and grow NOPAT by 10% compounded annually for the next decade, the stock is worth just \$17/share today – a 50% downside. [See the math behind this dynamic DCF scenario](#).

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

As investors [focus more](#) on fundamental research, research automation technology is needed to analyze all the critical financial [details in financial filings](#). Below are specifics on the adjustments we make based on Robo-Analyst findings in ACI Worldwide’s 2018 10-K:

Income Statement: we made \$65 million of adjustments, with a net effect of removing \$33 million in [non-operating expenses](#) (3% of revenue). You can see all the adjustments made to ACIW’s income statement [here](#).

Balance Sheet: we made \$587 million of adjustments to calculate invested capital with a net increase of \$77 million. One of the largest adjustments was \$125 million due to [goodwill](#). This adjustment represented 7% of reported net assets. You can see all the adjustments made to ACIW’s balance sheet [here](#).

Valuation: we made \$906 million of adjustments with a net effect of decreasing shareholder value by \$710 million. Apart from \$731 million in total debt, the most notable adjustment to shareholder value was \$72 million in outstanding ESO’s after tax. This adjustment represents 2% of ACIW’s market cap. See all adjustments to ACIW’s valuation [here](#).

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

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New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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