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

20 new stocks make our Most Attractive list this month, and 21 new stocks fall onto the Most Dangerous list this month. August's Most Attractive and Most Dangerous stocks were made available to members on August 7, 2019.

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 investments[2].

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.

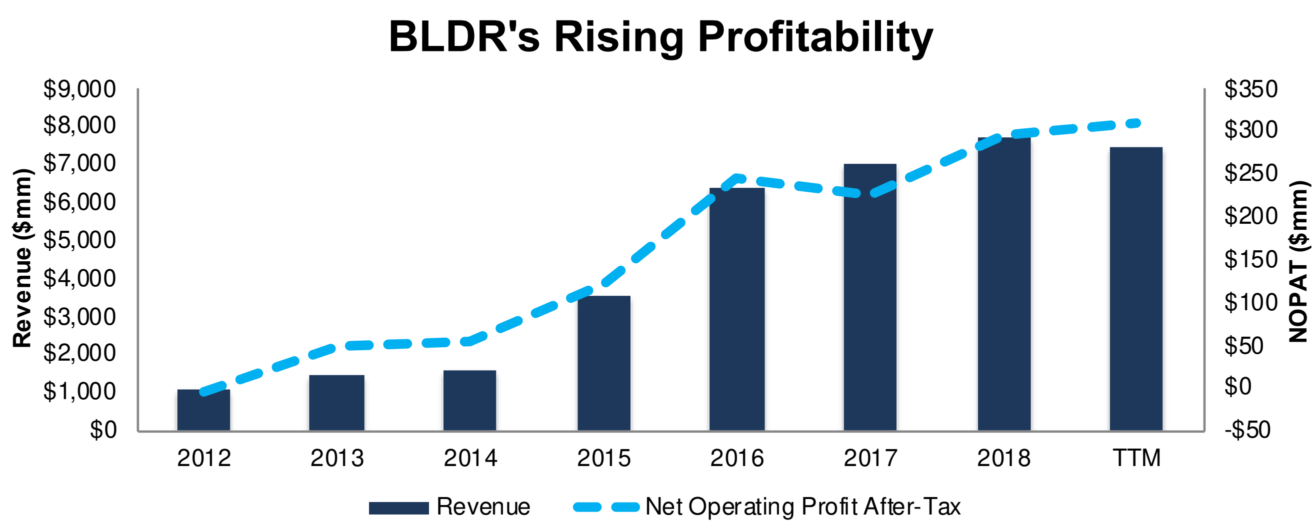
Most Attractive Stocks Feature for August: Builders FirstSource (BLDR: $19/share)

Builders FirstSource (BLDR) is the featured stock from August's Most Attractive Stocks Model Portfolio.

We first made BLDR a Long Idea on May 15, 2019. Since then, BLDR is up 19% while the S&P 500 is up 3%.

Since 2012, BLDR's revenue has grown 39% compounded annually while after-tax profit (NOPAT) has grown from -$57 million in 2012 to $311 over the trailing twelve months (TTM). BLDR's current return on invested capital (ROIC) is 12%, the highest it's been since 2006.

Figure 1: BLDR's Revenue & NOPAT Since 2012



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] This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

BLDR Valuation Provides Significant Upside Potential

At its current price of $19/share, BLDR has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects BLDR's NOPAT to permanently decline by 10%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 10% compounded annually since 2016.

If BLDR can maintain TTM NOPAT margins (4%) and grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $32/share today – a 66% 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 Builders FirstSource's 2018 10-K:

Income Statement: we made $154 million of adjustments, with a net effect of removing $90 million in non-operating expense (1% of revenue). You can see all the adjustments made to BLDR's income statement here.

Balance Sheet: we made $407 million of adjustments to calculate invested capital with a net increase of $318 million. One of the largest adjustments was $265 million in operating leases. This adjustment represented 12% of reported net assets. You can see all the adjustments made to BLDR's balance sheet here.

Valuation: we made $1.6 billion of adjustments with a net effect of decreasing shareholder value by $1.6 billion. There were no adjustments that increased shareholder value. See all adjustments to BLDR's valuation here.

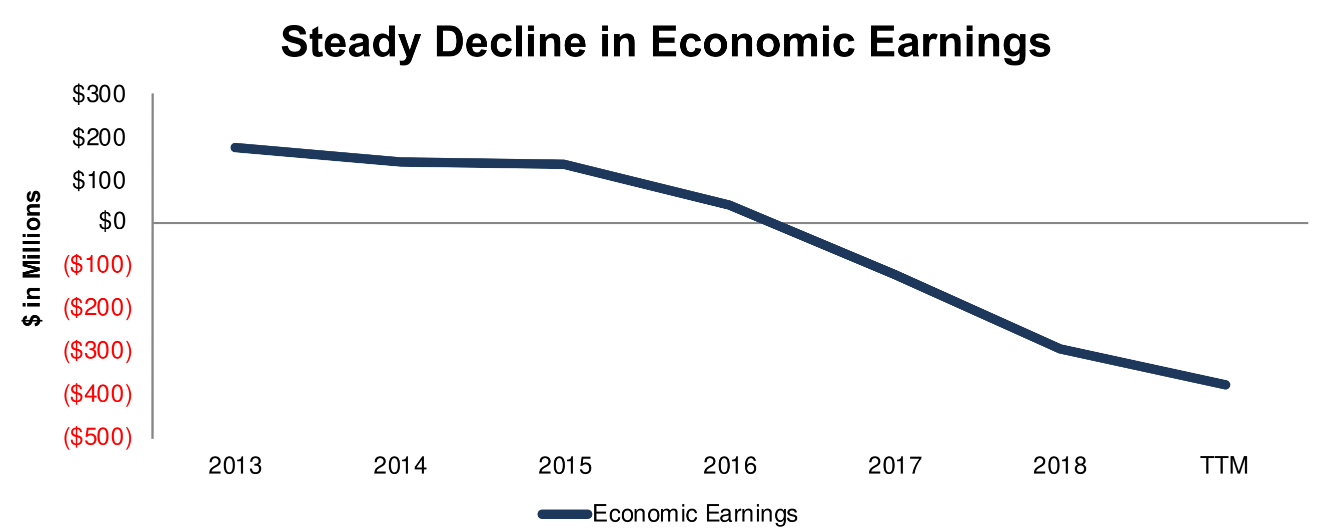
Most Dangerous Stocks Feature: Dentsply Sirona (XRAY: $53/share)

Dentsply Sirona (XRAY) is the featured stock from August's Most Dangerous Stocks Model Portfolio.

We put XRAY in the Danger Zone on October 2, 2017. We closed our short recommendation 224 days later on May 15, 2018, with the stock down 16% vs. the S&P 500 up 8%. Since we closed our position, XRAY is back up 14%, and the fundamentals have deteriorated even further. This combination of rising valuation and declining cash flows puts XRAY back on the Most Dangerous Stocks list.

From 2013 to the TTM period, XRAY's economic earnings declined from $175 million to -$375 million. XRAY has tried to stabilize its declining cash flows through large acquisitions and leadership changes, but nothing has succeeded in turning the business around so far.

Figure 2: XRAY's Economic Earnings Since 2013



Sources: New Constructs, LLC and company filings

XRAY Provides Poor Risk/Reward

Despite the deterioration in fundamentals, XRAY is priced for significant profit growth.

To justify its current price of $53/share, XRAY must achieve its 2016 NOPAT margins of 14% (compared to 7% TTM) and grow NOPAT by 9% compounded annually for the next 10 years. See the math behind this dynamic DCF scenario. This expectation seems overly optimistic given that XRAY's NOPAT has grown by just 1% compounded annually over the past decade (which has been the longest economic expansion in US history).

Even if XRAY can maintain 2018 margins of 9% and grow NOPAT by 5% compounded annually for the next decade, the stock is worth only $30/share today – a 44% 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 Dentsply Sirona's 2018 10-K:

Income Statement: we made $1.5 billion of adjustments, with a net effect of removing $1.4 billion in non-operating expense (35% of revenue). You can see all the adjustments made to XRAY's income statement here.

Balance Sheet: we made $4.3 billion of adjustments to calculate invested capital with a net increase of $4 billion. One of the largest adjustments was $3 billion in asset write-downs. This adjustment represented 40% of reported net assets. You can see all the adjustments made to XRAY's balance sheet here.

Valuation: we made $2.6 billion of adjustments with a net effect of decreasing shareholder value by $2.5 billion. The largest adjustment to shareholder value was $501 million in deferred tax liabilities. This adjustment represents 4% of XRAY's market cap. See all adjustments to XRAY's valuation here.

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

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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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