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

Recap from August's Picks

Our Most Attractive Stocks (-0.8%) underperformed the S&P 500 (+0.8%) from August 7, 2019 through September 3, 2019. The best performing large cap stock gained 12% and the best performing small cap stock was up 21%. Overall, 14 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-3.5%) outperformed the S&P 500 (+0.8%) as a short portfolio from August 7, 2019 through September 3, 2019. The best performing large cap stock fell by 17% and the best performing small cap stock fell by 43%. Overall, 31 out of the 40 Most Dangerous stocks outperformed the S&P 500.

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].

12 new stocks make our Most Attractive list this month, and 16 new stocks fall onto the Most Dangerous list this month. September's Most Attractive and Most Dangerous stocks were made available to members on September 5, 2019.

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.

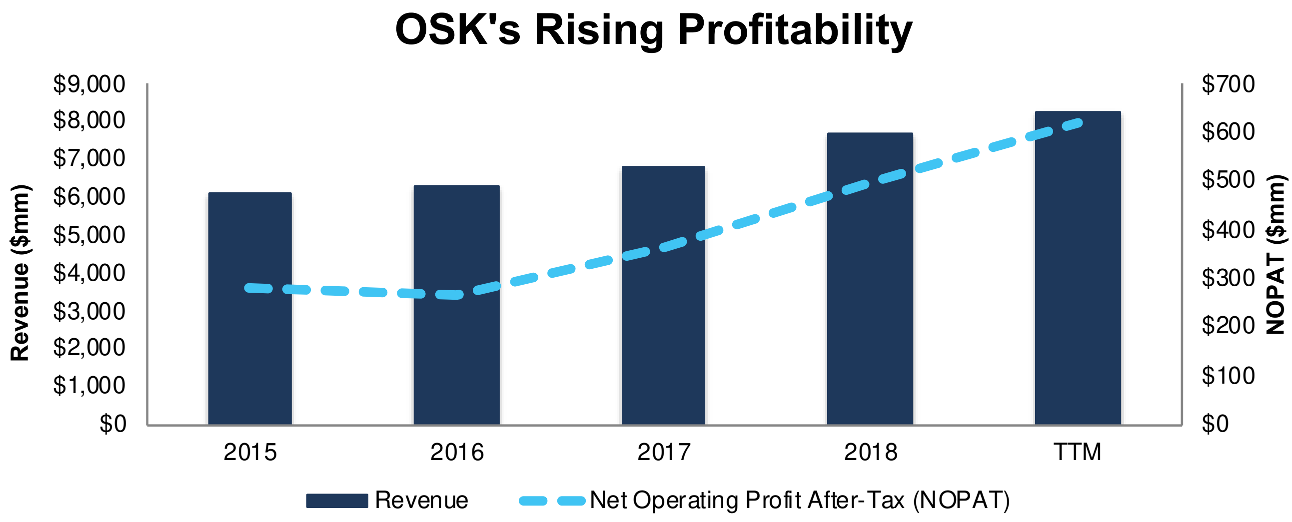
Most Attractive Stocks Feature for September: Oshkosh Corporation (OSK: $77/share)

Oshkosh (OSK) is the featured stock from September's Most Attractive Stocks Model Portfolio. We first made OSK a Long Idea on August 7, 2019.

Since 2015, OSK's revenue has grown 8% compounded annually while after-tax profit (NOPAT) has grown 21% compounded annually. OSK's trailing twelve month (TTM) NOPAT is up 33% over the prior TTM period. NOPAT margin has improved from 5% in 2015 to 8% TTM while its return on invested capital (ROIC) improved from 6% to 12% over the same time.

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.

Figure 1: OSK's Revenue & NOPAT Since 2015



Sources: New Constructs, LLC and company filings

OSK Valuation Offers Upside Potential

At its current price of $77/share, OSK has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects OSK's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 21% compounded annually since 2015 and 3% compounded annually over the past decade.

If OSK can maintain TTM NOPAT margins (8%) and grow NOPAT by just 5% compounded annually for the next decade, the stock is worth $106/share today – a 38% upside. See the math behind this reverse 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 Oshkosh's 2018 10-K:

Income Statement: we made $266 million of adjustments, with a net effect of removing $27 million in non-operating expense (<1% of revenue). You can see all the adjustments made to OSK's income statement here.

Balance Sheet: we made $1.7 billion of adjustments to calculate invested capital with a net increase of $1.3 billion. One of the largest adjustments was $1.2 billion due to asset write-downs. This adjustment represented 33% of reported net assets. You can see all the adjustments made to OSK's balance sheet here.

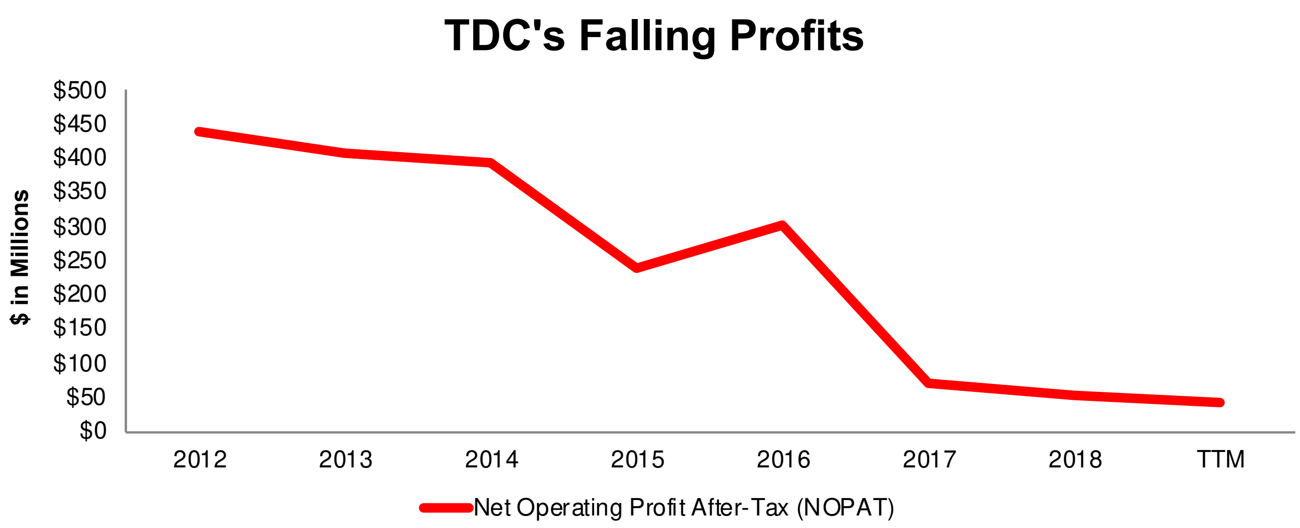
Valuation: we made $1.1 billion of adjustments with a net effect of decreasing shareholder value by $1.1 billion. Apart from $894 million in total debt, the largest adjustment was $118 million in underfunded pensions. This adjustment represents 2% of OSK's market cap. See all adjustments to OSK's valuation here.

Most Dangerous Stocks Feature: Teradata (TDC: $34/share)

Teradata (TDC) is the featured stock from September's Most Dangerous Stocks Model Portfolio.

Since 2012, TDC's NOPAT has declined by 30% compounded annually. TTM NOPAT is down 46% over the prior TTM period, per Figure 2. NOPAT margin has fallen from 13% in 2008 to 2% TTM while ROIC fell from 51% to 3% over the same time.

Figure 2: TDC's NOPAT Since 2012



Sources: New Constructs, LLC and company filings

TDC Provides Poor Risk/Reward

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

To justify its current price of $34/share, TDC must achieve NOPAT margins of 4% (double TTM margins of 2%) and grow NOPAT by 21% compounded annually for the next 10 years. See the math behind this reverse DCF scenario. This expectation seems overly optimistic given that TDC's NOPAT declined by 30% compounded annually since 2012.

Even if TDC can achieve 4% NOPAT margins and grow NOPAT by 12% compounded annually for the next decade, the stock is worth only $16/share today – a 53% downside. See the math behind this reverse 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 Teradata's 2018 10-K:

Income Statement: we made $89 million of adjustments, with a net effect of removing $24 million in non-operating expense (1% of revenue). You can see all the adjustments made to TDC's income statement here.

Balance Sheet: we made $1.5 billion of adjustments to calculate invested capital with a net increase of $105 million. One of the largest adjustments was $566 million due to asset write-downs. This adjustment represented 42% of reported net assets. You can see all the adjustments made to TDC's balance sheet here.

Valuation: we made $1.3 billion of adjustments with a net effect of decreasing shareholder value by $251 million. Apart from $642 million in total debt, the largest adjustment was $118 million in underfunded pensions. This adjustment represents 3% of TDC's market cap. See all adjustments to TDC's valuation here.

This article originally published on September 12, 2019.

Disclosure: David Trainer and Kyle Guske II 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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