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

Recap from November's Picks

Our Most Attractive Stocks (-0.3%) underperformed the S&P 500 (+1.2%) from November 6, 2019 through December 2, 2019. The best performing large cap stock gained 13% and the best performing small cap stock was up 12%. Overall, 15 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-0.4%) outperformed the S&P 500 (+1.2%) as a short portfolio from November 6, 2019 through December 2, 2019. The best performing large cap stock fell by 12% and the best performing small cap stock fell by 16%. Overall, 26 out of the 40 Most Dangerous stocks outperformed the S&P 500 as shorts.

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "Core Earnings: New Data and Evidence." 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].

14 new stocks make our Most Attractive list this month, and 15 new stocks fall onto the Most Dangerous list this month. December's Most Attractive and Most Dangerous stocks were made available to members on December 4, 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.

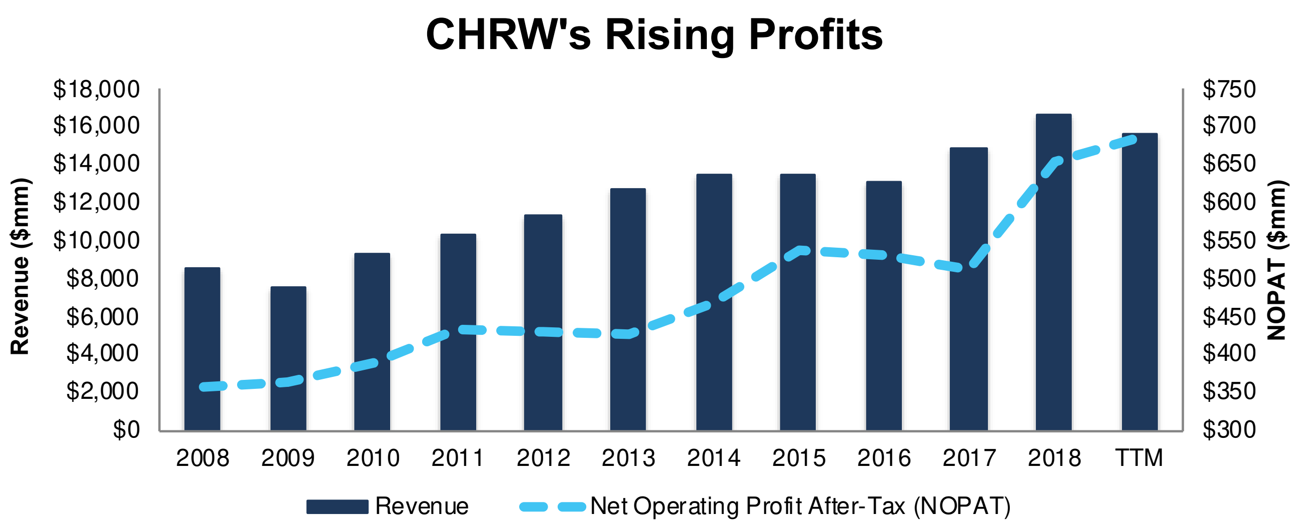
Most Attractive Stocks Feature for December: C.H. Robinson Worldwide (CHRW: 76/share)

C.H. Robinson Worldwide (CHRW) is the featured stock from December's Most Attractive Stocks Model Portfolio.

Over the past decade, CHRW has grown after-tax profit (NOPAT) by 6% compounded annually. CHRW's trailing twelve month (TTM) NOPAT is up 12% over the prior TTM period as well. CHRW's NOPAT margin has averaged 4% over the past decade and is 4.4% over the TTM period. After declining during 2015-2017, CHRW's return on invested capital (ROIC) improved from 17% in 2017 to 21% TTM.

[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: CHRW's Revenue & NOPAT Since 2008



Sources: New Constructs, LLC and company filings

CHRW Valuation Offers Upside Potential

At its current price of $76/share, CHRW has a price-to-economic book value (PEBV) ratio of 1.0. This ratio means the market expects CHRW's NOPAT to never meaningfully grow from current levels. This expectation seems overly pessimistic for a firm that has grown NOPAT by 6% compounded annually over the past decade and 15% compounded annually over the past two decades.

If CHRW can maintain its TTM NOPAT margin (4.4%) and grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $101/share today – a 33% 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 as shown in the Harvard Business School and MIT Sloan paper, "Core Earnings: New Data and Evidence".

Below are specifics on the adjustments we make based on Robo-Analyst findings in C.H. Robinson's 2018 10-K:

Income Statement: we made $95 million of adjustments, with a net effect of removing $9 million in non-operating income (<1% of revenue). You can see all the adjustments made to CHRW's income statement here.

Balance Sheet: we made $359 million of adjustments to calculate invested capital with a net increase of $264 million. One of the largest adjustments was $219 million in operating leases. This adjustment represented 7% of reported net assets. You can see all the adjustments made to CHRW's balance sheet here.

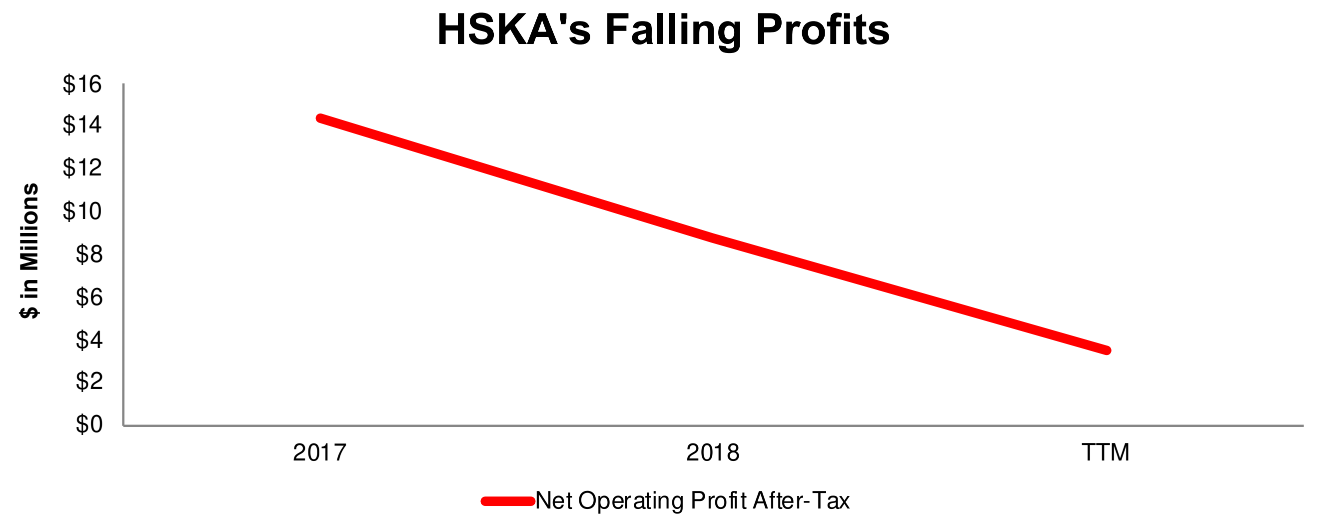
Valuation: we made $1.6 billion of adjustments with a net effect of decreasing shareholder value by $1.6 billion. There were no adjustments that increased shareholder value. Apart from total debt, which includes the operating leases noted above, the largest adjustment to shareholder value was $104 million in outstanding employee stock options. This adjustment represents 1% of CHRW's market cap. See all adjustments to CHRW's valuation here.

Most Dangerous Stocks Feature: Heska Corporation (HSKA: $95/share)

Heska Corporation (HSKA) is the featured stock from December's Most Dangerous Stocks Model Portfolio.

HSKA's NOPAT has declined from $14 million in 2017 to just $4 million TTM, per Figure 2. HSKA's NOPAT margin has fallen from 11% in 2017 to 3% TTM while ROIC fell from 13% to 3% over the same time.

Figure 2: HSKA's NOPAT Since 2017



Sources: New Constructs, LLC and company filings

HSKA Provides Poor Risk/Reward

Despite its deteriorating fundamentals, HSKA is still priced for significant profit growth.

To justify its current price of $95/share, HSKA must achieve 2018 NOPAT margins of 7% (compared to 3% TTM) and grow NOPAT by 15% compounded annually for the next 14 years. See the math behind this reverse DCF scenario. This expectation seems overly optimistic given that HSKA's NOPAT and margins have fallen precipitously in the last two years.

Even if we assume HSKA can achieve a 7% NOPAT margin and grow NOPAT by 8%compounded annually for the next decade, the stock is worth only $33/share today – a 65% 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 as shown in the Harvard Business School and MIT Sloan paper, "Core Earnings: New Data and Evidence".

Below are specifics on the adjustments we make based on Robo-Analyst findings in Heska Corporation's 2018 10-K:

Income Statement: we made $13 million of adjustments, with a net effect of removing $3 million in non-operating expense (2% of revenue). You can see all the adjustments made to HSKA's income statement here.

Balance Sheet: we made $60 million of adjustments to calculate invested capital with a net decrease of $7 million. One of the largest adjustments was $14 million due to deferred tax assets. This adjustment represented 10% of reported net assets. You can see all the adjustments made to HSKA's balance sheet here.

Valuation: we made $161 million of adjustments with a net effect of decreasing shareholder value by $12 million. The largest adjustment to shareholder value was $74 million in excess cash. This adjustment represents 10% of HSKA's market cap. See all adjustments to HSKA's valuation here.

This article originally published on December 11, 2019.

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

Follow us on Twitter, Facebook, LinkedIn, and StockTwits for real-time alerts on all our research.

Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

HBS & MIT Sloan research reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies (featured by Harvard Business School), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

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

Learn more.

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

"…the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications." – page 20

Pick better stocks:

"Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year." – Abstract

Avoid losses from using other firms' data:

"…many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat…" – page 14

Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

"An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A." – page 33-34

DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.