



## Featured Stocks in February's Most Attractive/Most Dangerous Model Portfolios

### Recap from January's Picks

Our Most Attractive Stocks (-3.9%) underperformed the S&P 500 (+1.9%) from January 7, 2020 through February 4, 2020. The best performing large cap stock gained 10% and the best performing small cap stock was up 4%. Overall, 7 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-1.6%) outperformed the S&P 500 (+1.9%) as a short portfolio from January 7, 2020 through February 4, 2020. The best performing large cap stock fell by 8% and the best performing small cap stock fell by 14%. Overall, 23 out of the 36 Most Dangerous stocks outperformed the S&P 500 as shorts.

Get the best fundamental research

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](#)<sup>1</sup>, which helps clients fulfill the [fiduciary duty of care](#) and make smarter investments<sup>2</sup>.

15 new stocks make our Most Attractive list this month, and two new stocks fall onto the Most Dangerous list this month. February's Most Attractive and Most Dangerous stocks were made available to members on February 6, 2020.

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 February: AutoZone Inc. (AZO: \$1,059/share)

AutoZone Inc. (AZO), is the featured stock from February's [Most Attractive Stocks Model Portfolio](#). We most recently made AZO a Long Idea in [November 2018](#). The stock is up 34% (S&P 500 +19%) since our report and remains undervalued.

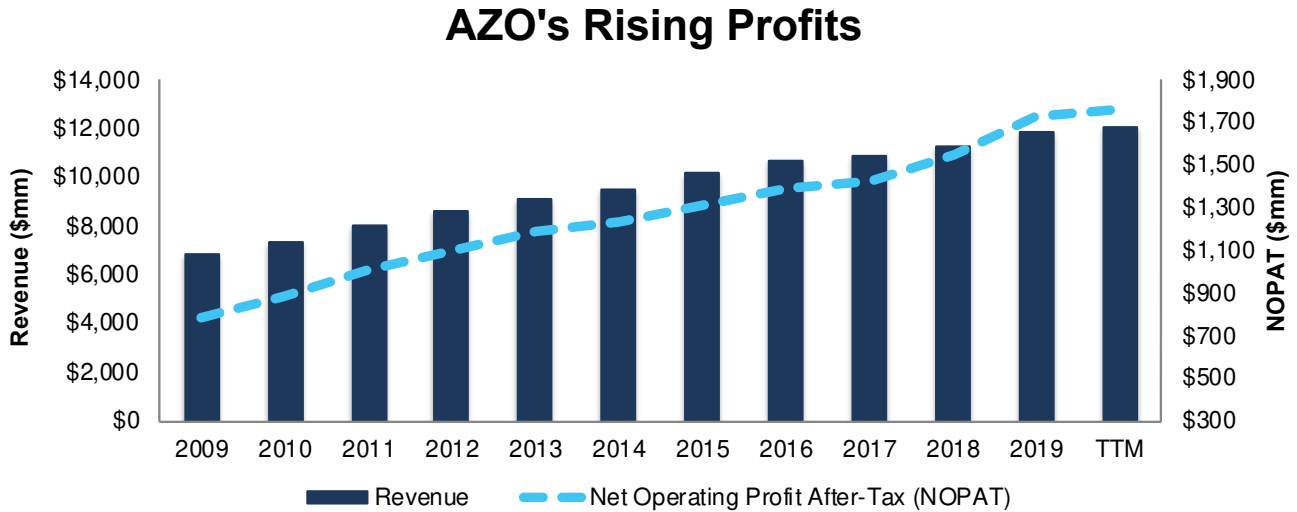
Over the past decade, AZO has grown after-tax profit ([NOPAT](#)) by 8% compounded annually. AZO's trailing twelve month (TTM) NOPAT is up 14% over the prior TTM period. AZO's NOPAT margin has increased from 12% in 2009 to 15% TTM while its ROIC improved from 19% to 26% over the same time.

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

<sup>2</sup> This [paper](#) compares our analytics on a mega cap company to Bloomberg and Capital IQ (SPGI) in a detailed appendix.



**Figure 1: AZO's Revenue & NOPAT Since 2009**



Sources: New Constructs, LLC and company filings

#### AZO's Valuation Offers Upside Potential

At its current price of \$1,059/share, AZO has a price-to-economic book value ([PEBV](#)) ratio of 0.8. This ratio means the market expects AZO's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 8% compounded annually over the past decade and 10% compounded annually over the past two decades.

If AZO can maintain its TTM NOPAT margin (15%) and grow NOPAT by just 4% compounded annually for the next decade, the stock is worth \$1,970/share today – an 86% 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 AutoZone's 2019 10-K:

**Income Statement:** we made \$454 million of adjustments, with a net effect of removing \$113 million in [non-operating expense](#) (<1% of revenue). You can see all the adjustments made to AZO's income statement [here](#).

**Balance Sheet:** we made \$2.5 billion of adjustments to calculate invested capital with a net increase of \$2.3 billion. One of the largest adjustments was \$1.8 billion due to [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 \$8.1 billion of adjustments with a net effect of decreasing shareholder value by \$8.1 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 \$556 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: Altra Industrial Motion Corp (AIMC: \$35/share)

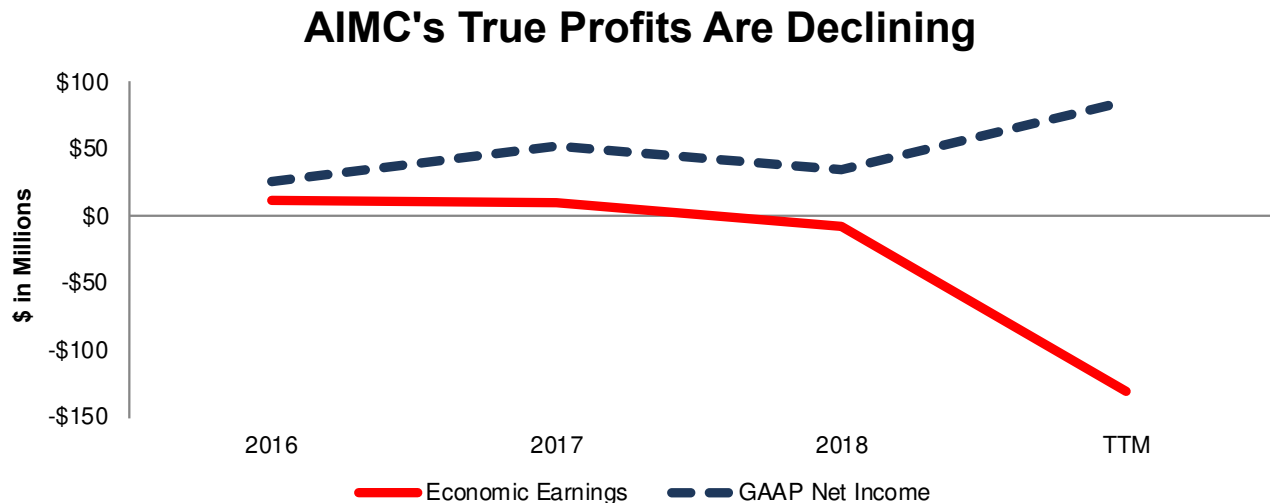
Altra Industrial Motion Corp (AIMC) is the featured stock from February's [Most Dangerous Stocks Model Portfolio](#).

AIMC's [economic earnings](#) have declined from \$16 million in 2011 to -\$131 million TTM. The disconnect between economic earnings and GAAP net income, per Figure 2, stems from the increased capital charge related to AIMC's \$2.5 billion acquisition of A&S Business in 2018. This acquisition failed to create shareholder



value and is detrimental to the firm’s overall profitability. AIMC’s [average invested capital turns](#) fell from 0.99 in 2017, the year before the acquisition, to 0.46 TTM while ROIC declined from 8% to 4% over the same time.

Figure 2: AIMC’s GAAP Net Income vs. Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

### AIMC Provides Poor Risk/Reward

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

To justify its current price of \$35/share, AIMC must achieve a NOPAT margin of 10% (compared to 9% TTM, which is the highest in the firm’s history) and grow NOPAT by 12% compounded annually for the next 12 years. [See the math behind this reverse DCF scenario](#). This expectation seems overly optimistic given that AIMC’s NOPAT has grown by just 7% compounded annually over the past decade.

Even if we assume AIMC can maintain a 9% NOPAT margin (highest ever) and grow NOPAT by 11% compounded annually for the next decade, the stock is worth only \$22/share today – a 37% 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 Altra Industrial Motion Corp’s 2018 10-K:

Income Statement: we made \$98 million of adjustments, with a net effect of removing \$57 million in [non-operating expense](#) (5% of revenue). You can see all the adjustments made to AIMC’s income statement [here](#).

Balance Sheet: we made \$2.7 billion of adjustments to calculate invested capital with a net decrease of \$2.3 billion. One of the largest adjustments was \$2.4 billion related to [mid-year acquisitions](#). This adjustment represented 60% of reported net assets. You can see all the adjustments made to AIMC’s balance sheet [here](#).

Valuation: we made \$2.2 billion of adjustments with a net effect of decreasing shareholder value by \$2.0 billion. Apart from total debt, the largest adjustment to shareholder value was \$394 million in [net deferred tax liabilities](#). This adjustment represents 17% of AIMC’s market cap. See all adjustments to AIMC’s valuation [here](#).

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

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## ***Footnotes adjustments matter. We are the ONLY source.***

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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*



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