Saving Investors from Meme Stocks: GameStop (GME)

Check out this week's Danger Zone interview with Chuck Jaffe of Money Life.

"I don't know what the f--- I'm doing, I just know I'm making money,"
Danny Tran in this TikTok video, also featured in The Wall Street Journal's It's All Just a Game to Me.

As more investors willfully admit they are gambling on stocks, we feel compelled to offer an easy way to make more informed decisions, and, hopefully, save people lots of money. Over the next few weeks, we're going to give investors research that shows when meme stocks' valuations get crazy, and they should sell. This week, we focus on GameStop (GME: $185/share) and put it in the Danger Zone.

Why Investors Need Independent Research

Wall Street isn't in the business of warning investors of the dangers in risky stocks because they make too much money from their trading volume and underwriting of debt and equity sales.

Only independent firms are free to provide unconflicted research and navigate Wall Street conflicts and analyst biases. With new technology to cut through the deluge of data in financial filings and overcome the flaws in Wall Street research, self-directed investors are better positioned than ever to make informed decisions.

What's the Problem Here?

The meme stock frenzy highlights the lack of reliable fundamental research, which creates a vacuum for mis-information that elevates sources like Reddit to undue levels of influence and leads investors to lose perspective.

Without reliable fundamental research, investors have no way of gauging whether a stock is expensive or cheap. Without a reliable measure of valuation, investors have little choice but to gamble if they want to own stocks. The lack of reliable fundamental research is a big problem if we want our market to have integrity and not unfairly advantage those with better information.

Figure 1: Mis-Information for Self-Directed Investors Is At an All-Time High

Image Source: Everipedia

Meme Stock #1: GameStop: Danger Zone Anywhere Above $45/share

GME was not worth owning anywhere above $45/share, given the company's fundamentals, as explained when we closed our Focus List: Long position in the stock in late January. Nevertheless, the stock went on to climb as high as $347/share before taking a roller coaster path back to ~$185/share. See Figure 2.

Figure 2: Fundamental Research to Know When to Sell GME

Sources: New Constructs, LLC and company filings

To give readers a sense of just how crazy overvalued the stock was at its peak, we do the math and show how the business would have to perform to justify $347/share.

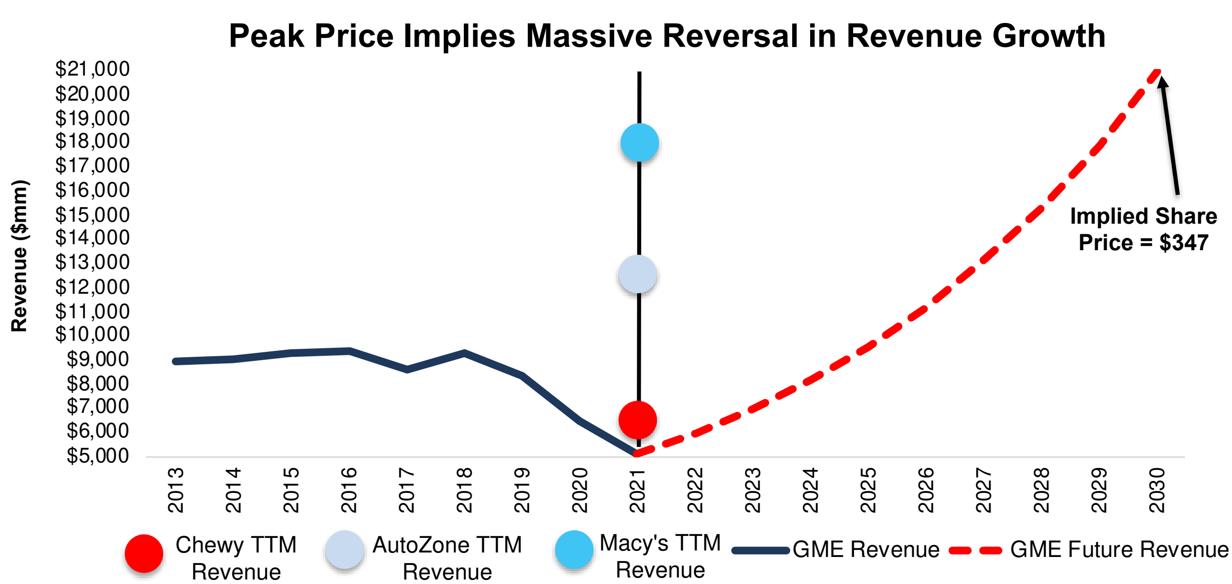
"Crazy" at $347 Explained: Implies More Revenue Than Macy's

Our reverse discounted cash flow (DCF) model is an excellent research tool to analyze the expectations implied by stock prices. To justify $347/share, it shows that GameStop must:

- improve its profit margin to 5.5% (10-yr avg from 2010-19 is 3.9% & all-time high was 4.8% in 2008) and
- grow revenue by 17% compounded annually through 2030 (above projected video game industry CAGR of 13% through 2027)

In this scenario, GameStop earns nearly $21 billion in revenue in 2030 or more than the trailing-twelve-months (TTM) revenue of Macy's (M), AutoZone (AZO), and Chewy Inc. (CHWY). See Figure 3 for details.

Figure 3: GameStop's Historical Revenue vs. DCF Implied Revenue: Scenario 1



Sources: New Constructs, LLC and company filings

For reference, GameStop's revenue fell by 3% compounded annually from 2009 to 2019.

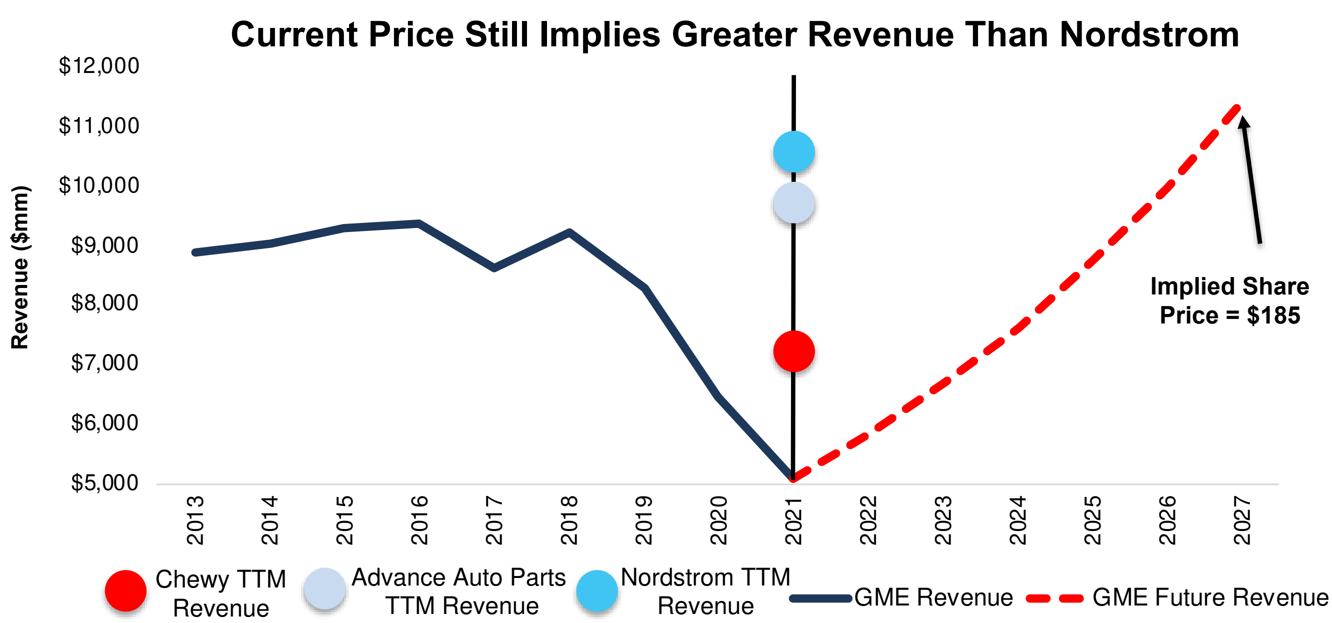
Still Crazy: At $185

For perspective on the current price, we run the same analysis to show what the company must do to justify $185/share:

- immediately improve its profit margin to 4.8% (all-time high in 2008 compared to 0.7% in 2019) and
- grow revenue by 15% compounded annually through 2027 (above projected video game industry CAGR of 13% through 2027)

In this scenario, GameStop earns over $11 billion in revenue in 2027, which is 19% higher than GameStop's record revenue of $9.6 billion in 2012 and the TTM revenue of Nordstrom (JWN), Advance Auto Parts (AAP), and Chewy. See Figure 4 for details.

Figure 4: GameStop's Historical Revenue vs. DCF Implied Revenue: Scenario 2



Sources: New Constructs, LLC and company filings

More Reliable Fundamental Research on other Meme Stocks

With a better grasp on fundamentals[1], investors have a better sense of when to buy and sell – and – know how much risk they take when they own a stock at certain levels.

In the coming weeks, we will perform this same analysis on other meme stocks: AMC Entertainment (AMC), Blackberry (BB), Express Inc. (EXPR) Genius Brands (GNUS), Koss Corporation (KOSS), Naked Brands Group (NAKD), and Nokia (NOK). Each of these stocks were on Robinhood's restricted stocks list and each saw a major rise and fall in late January.

We will also feature other meme stocks that trade at levels entirely disconnected from fundamental reality, such as Netflix (NFLX) and Tesla (TSLA).

[1] Only Core Earnings enable investors to overcome the inaccuracies, omissions and biases in legacy fundamental data and research, as proven in Core Earnings: New Data & Evidence, a forthcoming paper in The Journal of Financial Economics written by professors at Harvard Business School (HBS) & MIT Sloan.

Figure 5: Meme Stocks Disconnected From Fundamental Reality

Company	Ticker
AMC Entertainment	AMC
Blackberry, Ltd.	BB
Express Inc.	EXPR
Genius Brands	GNUS
Koss Corporation	KOSS
Naked Brands Group	NAKD
Netflix	NFLX
Nokia Corporation	NOK
Tesla	TSLA

Sources: New Constructs, LLC and company filings

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

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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