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

Recap From March's Picks

Our Most Attractive Stocks (+8.5%) outperformed the S&P 500 (+6.8%) from March 3, 2021 through April 5, 2021 by 1.7%. The best performing large cap and small cap stocks gained 30% each. Overall, 20 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+5.6%) outperformed the S&P 500 (+6.8%) as a short portfolio from March 3, 2021 through April 5, 2021 by 1.2%. The best performing large cap stock fell by 9% and the best performing small cap stock fell by 10%. Overall, 13 out of the 20 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios outperformed as an equal-weighted long/short portfolio by 1.5%.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics , drives our research. Our proprietary Robo-Analyst Technology[1] scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

28 new stocks make our Most Attractive list this month, and 5 new stocks fall onto the Most Dangerous list this month. April's Most Attractive and Most Dangerous stocks were made available to members on April 7, 2021.

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 April: Dick's Sporting Goods Inc. (DKS: $82/share)

Dick's Sporting Goods Inc. is the featured stock from April's Most Attractive Stocks Model Portfolio.

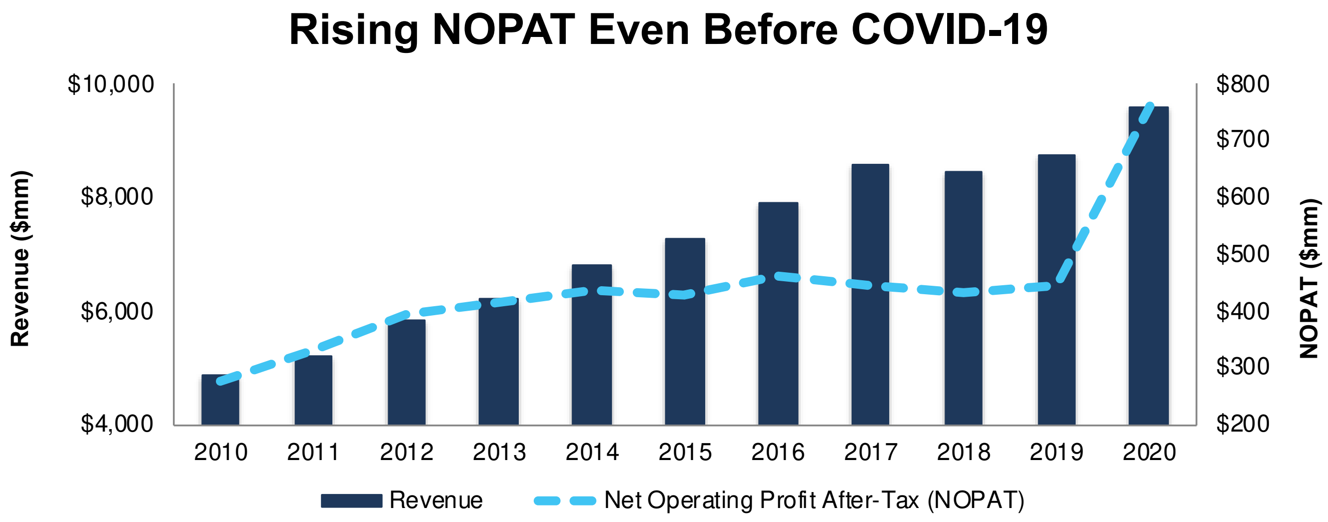
Dick's Sporting Goods grew revenue by 7% compounded annually and net operating profit after-tax (NOPAT) by 5% compounded annually from fiscal 2010-2019 (before the COVID-19 pandemic). In fiscal 2020, Dick's Sporting Goods' revenue grew 10% year-over-year (YoY), and NOPAT grew 72% YoY.

The firm's NOPAT margin increased from 6% in fiscal 2016 to 8% in fiscal 2020, while its invested capital turns increased from 1.3 to 1.6 over the same period. Rising margins and invested capital turns drive the increase in Dick's Sporting Goods ROIC from 8% in fiscal 2016 to 13% TTM.

In the five years before COVID-19, Dick's Sporting Goods generated $1.7 billion (23% of market cap) in cumulative free cash flow (FCF). In fiscal 2020, Dick's Sporting Goods generated $1.3 billion in FCF.

[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models overcome flaws in Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

Figure 1: Revenue & NOPAT Since Fiscal 2010



Sources: New Constructs, LLC and company filings
Dates represent Dick's Sporting Goods' "fiscal year"

DKS Is Undervalued

At its current price of $82/share, DKS has a price-to-economic book value (PEBV) ratio of 0.5. This ratio means the market expects Dick's Sporting Goods' NOPAT to permanently decline by 50%. This expectation seems overly pessimistic for a firm that grew NOPAT by 5% compounded annually in the decade prior to fiscal 2020.

Even if Dick's Sporting Goods' NOPAT margin falls to 5% (below its 10-year average of 6%, compared to 8% in fiscal 2020) and the firm grows revenue by just 2% compounded annually (equal to consensus revenue CAGR estimates over the next 3 years) for the next decade, the stock is worth $114/share today – a 39% upside. See the math behind this reverse DCF scenario[3].

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in Dick's Sporting Goods' 10-K:

Income Statement: we made $504 million of adjustments, with a net effect of removing $232 million in non-operating expenses (2% of revenue). You can see all the adjustments made to Dick's Sporting Goods' income statement here.

Balance Sheet: we made $2.1 billion of adjustments to calculate invested capital with a net decrease of $647 million. One of the most notable adjustments was $258 million in asset write-downs. This adjustment represented 5% of reported net assets. You can see all the adjustments made to Dick's Sporting Goods' balance sheet here.

Valuation: we made $4.6 billion of adjustments with a net impact of decreasing shareholder value by $2.2 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $1.2 billion in excess cash. This adjustment represents 16% of Dick's Sporting Goods' market cap. See all adjustments Dick's Sporting Goods' valuation here.

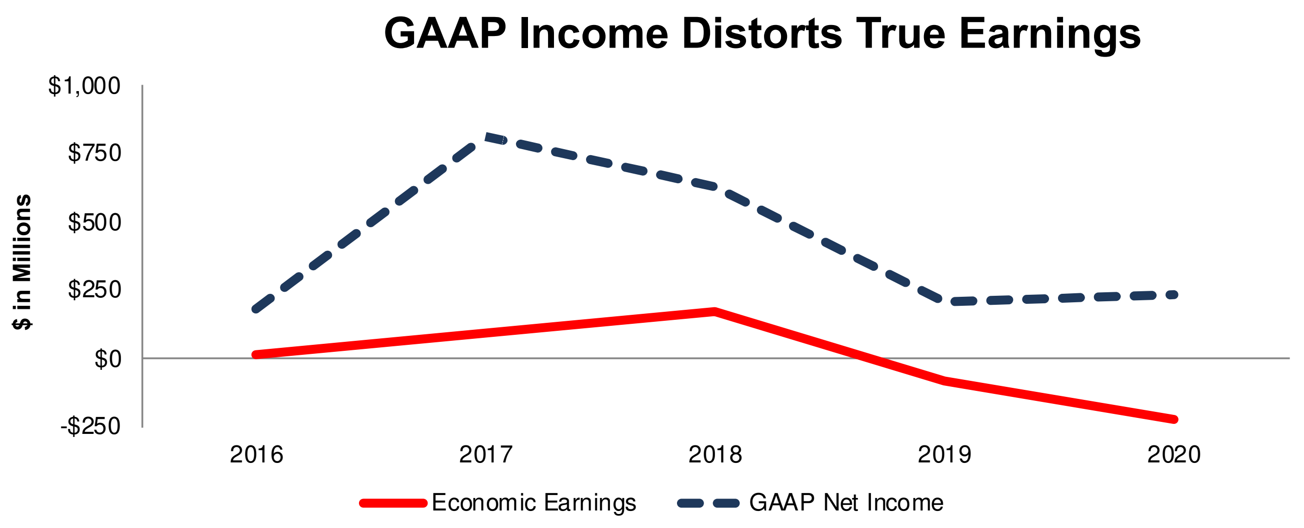
[3] All dates in our reverse DCF scenarios for Dick's Sporting Goods refer to the year in which the firm files it's 10-K, which may differ from the year Dick's Sporting Goods uses to describe its fiscal year. For instance, in our reverse DCF model, EY 10: 2031 would refer to what Dick's Sporting Goods would call fiscal 2030.

Most Dangerous Stocks Feature: ON Semiconductor Corp (ON: $42/share)

ON Semiconductor Corp (ON) is the featured stock from April's Most Dangerous Stocks Model Portfolio.

ON Semiconductor's GAAP net income improved from $182 million in 2016 to $234 million in 2020. However, the firm's economic earnings, the true cash flows of the business, fell from $11 million to -$218 million over the same time. The firm's NOPAT margin fell from 10% in 2016 to 7% in 2020, while ROIC fell from 7% to 4%.

Figure 2: Misleading GAAP Net Income vs. Economic Earnings



Sources: New Constructs, LLC and company filings

ON Provides Poor Risk/Reward

Despite its poor fundamentals, ON is still priced for significant profit growth and is overvalued.

To justify its current price of $42/share, ON Semiconductor must immediately achieve a 13% NOPAT margin (highest since 2010 compared to 7% in 2020) and grow NOPAT by 18% compounded annually for the next decade. See the math behind this reverse DCF scenario. This expectation seems overly optimistic given the firm's NOPAT has fallen by 1% compounded annually over the past decade.

Even if ON Semiconductor can improve its NOPAT margin to 10% (vs. 7% in 2020) and grow NOPAT by 11% compounded annually for the next decade, the stock is worth just $21/share today, a 50% downside to the current stock price. See the math behind this reverse DCF scenario.

Each of these scenarios also assumes ON Semiconductor is able to grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create best-case scenarios that demonstrate how high expectations embedded in the current valuation are.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in ON Semiconductor's 10-K:

Income Statement: we made $403 million of adjustments, with a net effect of removing $112 million in in non-operating expenses (2% of revenue). You can see all the adjustments made to ON Semiconductor's income statement here.

Balance Sheet: we made $3.3 billion in adjustments to calculate invested capital with a net increase of $836 million. One of the largest adjustments was $1.4 billion in asset write-downs. This adjustment represented 20% of reported net assets. You can see all the adjustments made to ON Semiconductor's balance sheet here.

Valuation: we made $4.6 billion in adjustments with a net effect of decreasing shareholder value by $3.0 billion. Apart from total debt, the most notable adjustment to shareholder value was $818 million in excess cash. This adjustment represents 5% of ON Semiconductor's market cap. See all adjustments to ON Semiconductor's valuation here.

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Disclosure: David Trainer, Kyle Guske II, Alex Sword, 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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