Debt Spreads Based On More Reliable Fundamental Data

As part of our commitment to providing more reliable and transparent company valuation models, we are constantly adapting our processes and methodologies to changing market conditions and accounting rules. We recently improved the debt spread input to our weighted average cost of capital (WACC) calculation.

This report explains the update, which went into effect on Tuesday, May 18, and the impact it has on our models and Stock ratings.

The Update: Debt Spread Based on Our Credit Ratings

Our Credit Ratings now determine the debt spread used in the cost of debt calculation for the WACC. We no longer rely on ratings from legacy credit rating firms.

This update provides four key benefits to our models:

1. Better coverage: we provide Credit Ratings for 2,800 companies vs. ~1,500 from legacy providers.
2. Quarterly updates: legacy credit rating firms update their ratings once every few years, usually only when a company requests a new rating.
3. No conflicts: we're 100% independent and have no conflicts of interest with our clients. We aren't paid by companies or bankers for our credit or stock ratings.
4. More reliable: our ratings are based on better data & analytics while legacy fundamental datasets suffer from significant omissions, biases, and flaws.

What is the Debt Spread?

Debt spread is our proxy for the premium over the risk-free rate that a company would have to pay to borrow money. We estimate a company's marginal cost of debt as the debt spread plus the risk-free rate. More details here.

Impacts on our Models

This update impacts the following calculations in our models:

1. Cost of Debt will be updated much more frequently, whenever our Credit Rating for a company changes
2. WACC will change due to changes in Cost of Debt
3. Economic Earnings will change due to changes in WACC
4. Economic Book Value will change due to changes in WACC
5. Most values in our discounted cash flow (DCF) models will change due to any changes in WACC

How the Update Impacts your Portfolio and Stock Ratings

Five companies' Stock ratings changed due to this update:

A. Downgrade:
    1. Lawson Products (LAWS): from Neutral to Unattractive
B. Upgrades:
    1. Meredith Corporation (MDP): from Unattractive to Attractive
    2. Tenet Healthcare (THC): from Unattractive to Attractive
    3. United Natural Foods (UNFI): from Unattractive to Attractive
    4. VEON Ltd. (VEON): from Unattractive to Attractive

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Disclosure: David Trainer, Kyle Guske II, Hunter Anderson, 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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