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

Recap From November's Picks

Our Most Attractive Stocks (-3.8%) underperformed the S&P 500 (-2.0%) from November 3, 2021 through November 30, 2021 by 1.8%. The best performing large cap stock gained 1% and the best performing small cap stock was up 24%. Overall, 14 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-9.6%) outperformed the S&P 500 (-2.0%) as a short portfolio from November 3, 2021 through November 30, 2021 by 7.6%. The best performing large cap short stock fell by 51% and the best performing small cap short stock fell by 28%. Overall, 31 out of the 39 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 2.9%.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research and provides investors with a new source of alpha. 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.

Eleven new stocks make our Most Attractive list this month, and seventeen 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 2, 2021.

Our Most Attractive stocks all share a high and rising return on invested capital (ROIC) and low price to economic book value ratio. Most Dangerous stocks have misleading earnings and long growth appreciation periods implied by their market valuations.

Most Attractive Stocks Feature for December: Zions Bancorporation (ZION: $64/share)

Zions Bancorporation is the featured stock from December's Most Attractive Stocks Model Portfolio.

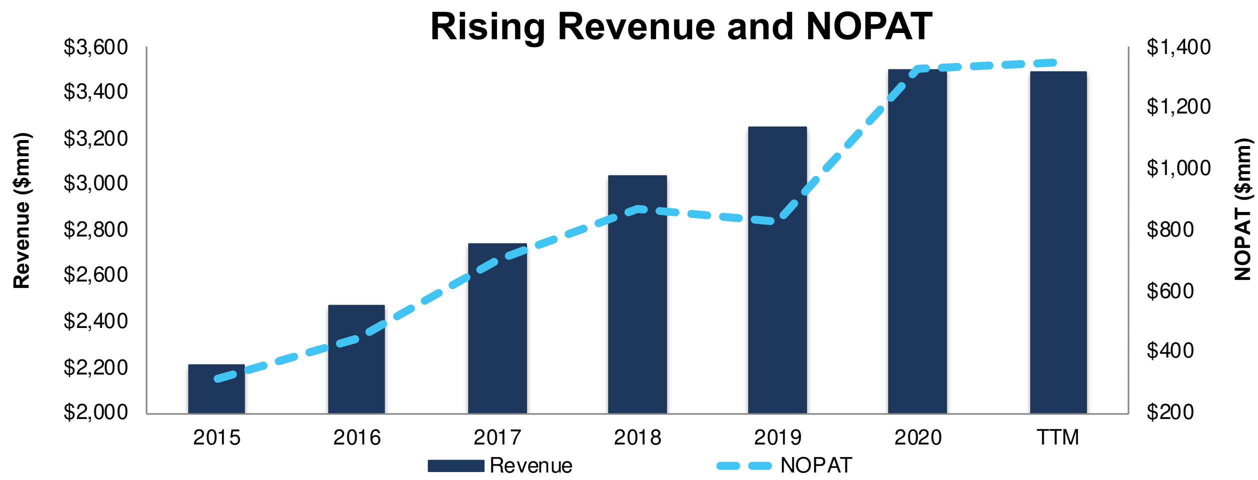
Zions has grown revenue by 10% compounded annually and net operating profit after-tax (NOPAT) by 33% compounded annually over the past five years.

The company's NOPAT margin increased from 14% in 2015 to 39% over the trailing twelve months (TTM), while invested capital turns rose from 0.2 to 0.3 over the same period. Rising margins and improved invested capital turns drove Zions' ROIC from 3% in 2015 to 12% over the TTM.

Zions generated $3.6 billion (36% of market cap) in cumulative free cash flow (FCF) over the past five years, and $1.3 billion in FCF over the TTM.

[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 2015



Sources: New Constructs, LLC and company filings

Zions Is Undervalued

At its current price of $64/share, ZION has a price-to-economic book value (PEBV) ratio of 0.4. This ratio means the market expects Zions' NOPAT to permanently decline by 60%. This expectation seems overly pessimistic for a company that has grown NOPAT by 10% compounded annually over the past two decades.

Even if Zions' NOPAT margin falls to 27% (equal to five-year average, compared to 39% TTM) and the company's NOPAT grows by <1% compounded annually for the next decade, the stock is worth $140/share today – a 119% upside. See the math behind this reverse DCF scenario. Should Zions grow profits more in line with historical levels, the stock has even more upside.

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

Below are specifics on the adjustments we make based on Robo-Analyst findings in Zions' 10-K and 10-Qs:

Income Statement: we made $483 million in adjustments, with a net effect of removing $279 million in non-operating expenses (8% of revenue). You can see all the adjustments made to Zions' income statement here.

Balance Sheet: we made $3.3 billion in adjustments to calculate invested capital with a net increase of $1.7 billion. One of the most notable adjustments was $1.2 billion in asset write-downs. This adjustment represented 14% of reported net assets. You can see all the adjustments made to Zions' balance sheet here.

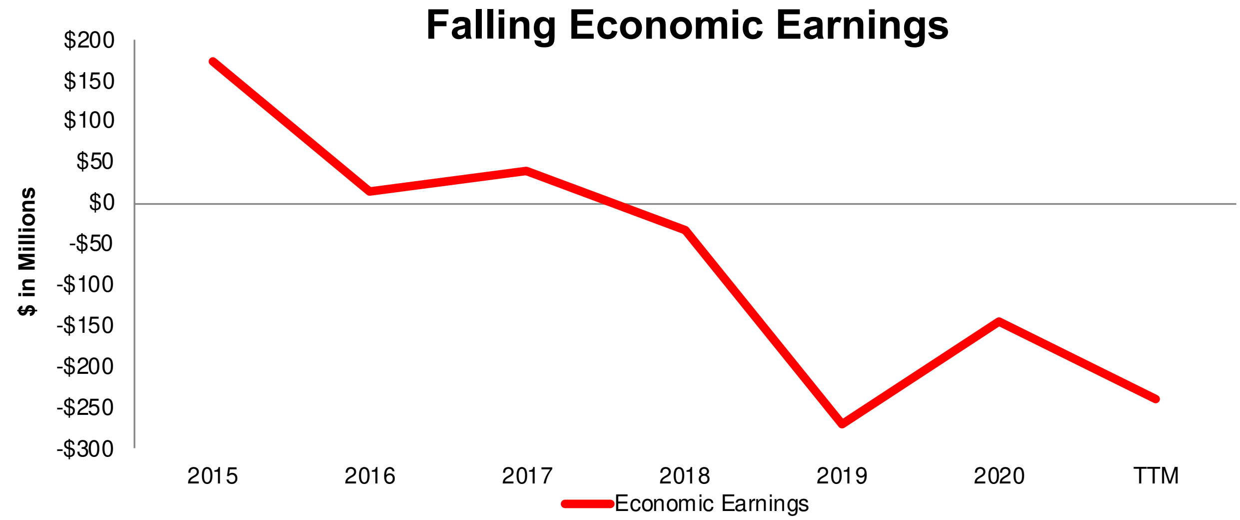
Valuation: we made $821 million of adjustments with a net effect of decreasing shareholder value by $581 million. One of the most notable adjustments to shareholder value was $440 million in preferred stock. This adjustment represents 4% of Zions' market cap. See all adjustments to Zions' valuation here.

Most Dangerous Stocks Feature: Stericycle Inc. (SRCL: $58/share)

Stericycle Inc. (SRCL) is the featured stock from December's Most Dangerous Stocks Model Portfolio.

Stericycle's economic earnings, the true cash flows of the business, fell from $173 million in 2015 to -$238 million over the TTM. The company's NOPAT margin fell from 15% in 2015 to 2% TTM, while invested capital turns fell from 0.6 to 0.4 over the same time. Falling NOPAT margins and invested capital turns drove Stericycle's ROIC from 9% in 2015 to 1% over the TTM.

Figure 2: Economic Earnings Since 2015



Sources: New Constructs, LLC and company filings

Stericycle Provides Poor Risk/Reward

Despite its poor fundamentals, Stericycle is priced for significant profit growth, and we believe the stock is overvalued.

To justify its current price of $58/share, Stericycle must improve its NOPAT margin to 8% (three-year average compared to 2% TTM) and grow NOPAT by 9% compounded annually for the next decade. See the math behind this reverse DCF scenario. Given that Stericycle's NOPAT fell 18% compounded annually since 2015, we think these expectations are overly optimistic.

Even if Stericycle can achieve a NOPAT margin of 8% and grow NOPAT by 5% compounded annually for the next decade, the stock is worth just $32/share today – a 45% downside to the current stock price. See the math behind this reverse DCF scenario. Should Stericycle's NOPAT grow at a slower rate or, even worse, continue its downward trend, the stock has even more downside.

Each of these scenarios also assumes Stericycle 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

Below are specifics on the adjustments we make based on Robo-Analyst findings in Stericycle's 10-K and 10-Qs:

Income Statement: we made $316 million in adjustments, with a net effect of removing $226 million in in non-operating expenses (8% of revenue). You can see all the adjustments made to Stericycle's income statement here.

Balance Sheet: we made $2.4 billion in adjustments to calculate invested capital with a net increase of $1.6 billion. One of the most notable adjustments was $926 million in asset write-downs. This adjustment represented 19% of reported net assets. You can see all the adjustments made to Stericycle's balance sheet here.

Valuation: we made $2.5 billion in adjustments, all of which decreased shareholder value. Apart from total debt, The most notable adjustment to shareholder value was $374 million in deferred tax liabilities. This adjustment represents 7% of Stericycle's market cap. See all adjustments to Stericycle's valuation here.

This article originally published on December 10, 2021.

Disclosure: David Trainer, Kyle Guske II, and Matt Shuler 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.

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.

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 two 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.