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DANGER ZONE
2/7/22

Another Falling Knife That Could Cut Your Portfolio – Part 1

We counsel investors not to try and catch falling knives – stocks that have seen steep declines but still have further to fall. As the market rotates away from high-flying growth names to more stable cash generators, investors need reliable fundamental research, more than ever, to protect their portfolios from falling knives.

We continue to post an exceptional hit rate on spotting overvalued stocks. Currently, 62 out of our 65 Danger Zone stock picks are down from their 52-week highs by more than the S&P 500. Figure 1 lists the open Danger Zone picks that are down at least 40% from their 52-week highs. Our Focus List Stocks: Short Model Portfolio, the best-of-the-best of our Danger Zone picks, outperformed the S&P 500 as a short portfolio by 36% in 2021 with 29 out of our 31 picks outperforming the index.

This report highlights one particularly dangerous falling knife: Allbirds (BIRD: $12/share). We highlight four other falling knives in other reports published today: Sweetgreen (SG: $31/share) here, Carvana (CVNA: $150/share) here, Wayfair (W: $140/share) here, and Shake Shack (SHAK: $64/share) here. Each of these stocks have dropped at least 40% from all-time highs, yet still carry at least 40% additional downside risk.

Figure 1: Danger Zone Picks Down >40% From 52-Week High – Performance through 2/4/22

Company	Ticker	Off 52-Week High
Peloton Interactive Inc.	PTON	-84%
Robinhood Markets Inc.	HOOD	-82%
Koss Corp	KOSS	-80%
AMC Entertainment Holdings	AMC	-79%
Cronos Group Inc.	CRON	-77%
GameStop Corporation	GME	-71%
Pinterest Inc.	PINS	-70%
Beyond Meat Inc.	BYND	-68%
Allbirds Inc.	BIRD	-67%
Rivian Automotive	RIVN	-66%
Affirm Holdings Inc.	AFRM	-64%
LivePerson Inc.	LPSN	-63%
DoorDash, Inc.	DASH	-62%
Express Inc.	EXPR	-60%
Carvana Co.	CVNA	-60%
Wayfair, Inc.	W	-60%
Spotify Technology	SPOT	-55%
Coinbase Global Inc.	COIN	-55%
Snap Inc.	SNAP	-53%
Domo Inc.	DOMO	-52%
Sweetgreen Inc.	SG	-52%
Diebold Nixdorf, Inc.	DBD	-52%
Squarespace Inc.	SQSP	-51%
Shopify Inc.	SHOP	-50%
Shake Shack, Inc.	SHAK	-49%
Eventbrite Inc.	EB	-46%
Warby Parker Inc.	WRBY	-45%
LYFT Inc.	LYFT	-45%
PROS Holdings, Inc.	PRO	-42%
Uber Technologies Inc.	UBER	-42%
Netflix Inc.	NFLX	-41%
Zendesk, Inc.	ZEN	-41%

Sources: New Constructs, LLC

Falling Knife: Allbirds (BIRD): Down 65% from 52-Wk High & 75%+ Downside Remaining

We put Allbirds in the Danger Zone in in September 2021 prior to its IPO. Since the opening price on IPO date, the stock is down 46% while the S&P 500 is up 1%, and Allbirds' shares could fall another 75%. We detail Allbirds' unprofitable and increasingly costly business model, strong competition, and poor fundamentals in our report here.

Allbirds Is Priced to Grow Revenue by 5x

Below, we use our reverse discounted cash flow (DCF) model to analyze the expectations for future growth in cash flows baked into Allbirds' current share price and show that it could fall 75%+ further. Note that Allbirds has yet to report its fourth quarter earnings.

To justify its current price of $12/share, Allbirds must:

- improve its NOPAT margin to 0% in 2021 (compared to -11% 2020), 2% in 2022, 5% in 2023, and 11% (midpoint of Nike's and Sketchers' TTM margins) from 2024-2030 and
- grow revenue by 19% (vs. 13% in 2020) compounded annually for the next ten years, which is over 8x the expected industry growth rate through 2026.

In this scenario, Allbirds would generate nearly $1.3 billion in revenue in 2030, which is 5x its 3Q21 revenue when annualized. In a mature, largely undifferentiated shoe and apparel market, the ability to grow 8x above industry rates implies huge market share gains. The stock's valuation also implies significant improvement in profitability, to levels above Skechers (SKX). Essentially, investors in Allbirds are betting the company can take market share and improve profitability at the same time in a hyper-competitive market.

Given that Allbirds' reported operating margin declined from -14% to -15% year-over-year (YoY) in the nine months ended September 30, the assumed margin improvement in this scenario looks highly unlikely. Companies that grow revenue by anywhere near 20%+ compounded annually for such a long period are also unbelievably rare, which make the expectations in Allbirds' share price even more unrealistic.

58% Downside If Growth Just Exceeds 2020 Levels

We review an additional DCF scenario to highlight the downside risk should Allbirds' revenue grow at 6x the projected industry growth rate.

If we assume Allbirds:

- improves its NOPAT margin to 0% in 2021, 2% in 2022, 5% in 2023, and 8% (average of Skechers and Wolverine World Wide's TTM margins) from 2024-2030 and
- grows revenue by 14% (vs. 13% in 2020) compounded annually from 2021-2030, then

Allbirds is worth just $5/share today – a 58% downside.

75% Downside Even if Allbirds Triples Long-Term Industry Growth Rate

We review a final DCF scenario to highlight the downside risk should Allbirds' grow revenue three times as fast as industry expectations, given that it is starting from such a small base.

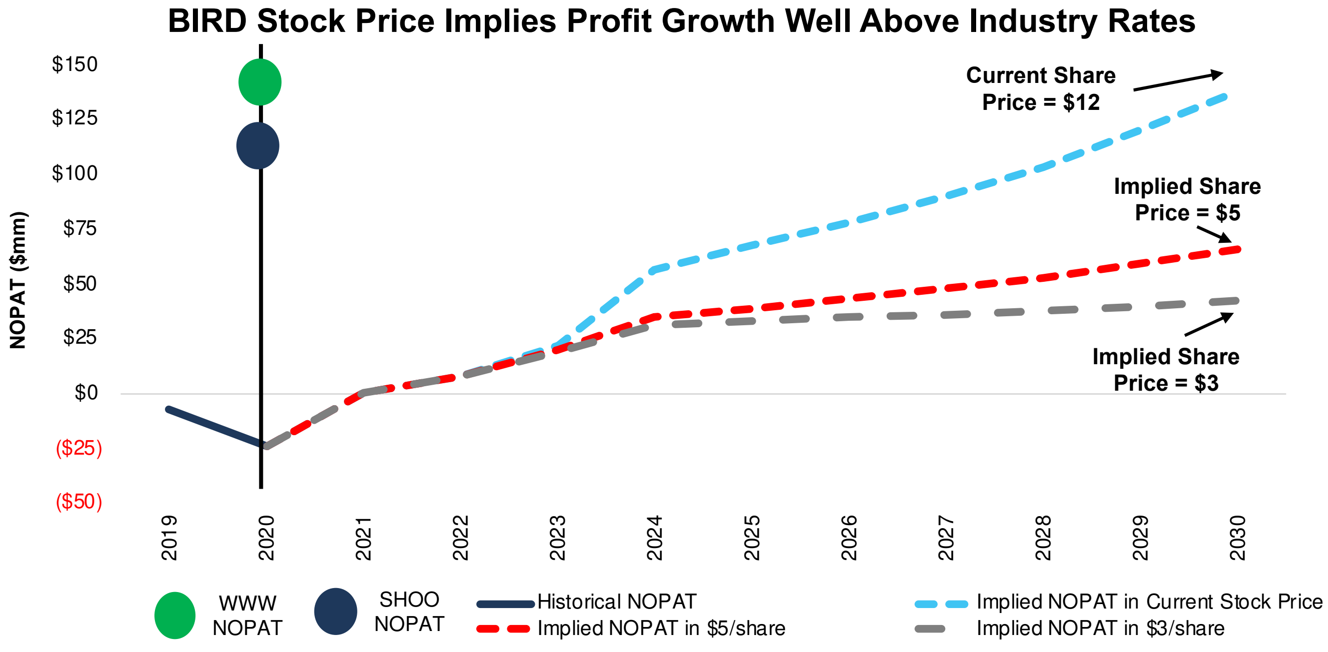
If we assume Allbirds:

- improves its NOPAT margin to 0% in 2021 (compared to -11% TTM), 2% in 2022, 5% in 2023, and 8% from 2024-2030 and
- grows revenue by 9% (3x projected industry growth through 2026) compounded annually from 2021-2030, then

the stock is worth just $3/share today – a 75% downside.

Figure 2 compares Allbirds implied future NOPAT in these scenarios to its NOPAT, along with the NOPAT of peers Wolverine World Wide (WWW) and Steve Madden (SHOO).

Figure 2: Allbirds' Historical and Implied NOPAT: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings

Each of the above scenarios also assumes Allbirds grows revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is highly unlikely given the firm's plans to ramp up its brick-and-mortar presence but allows us to create best-case scenarios that demonstrate the expectations embedded in the current valuation. For reference, Allbirds' invested capital nearly doubled from $83 million in 2019 to $160 million in 2020. If we assume Allbirds' invested capital increases at a similar rate in DCF scenarios 2 and 3 above, the downside risk is even larger.

Fundamental Research Provides Clarity in Frothy Markets

2022 has quickly shown investors that fundamentals matter and stocks don't only go up. With a better grasp on fundamentals, investors have a better sense of what and when to buy and sell – and – know how much risk they take when they own a stock at certain levels. Without reliable fundamental research, investors have no reliable way of knowing whether a stock is expensive or cheap.

As shown above, disciplined, reliable fundamental research shows that even after plummeting, Allbirds, Sweetgreen, Carvana, Wayfair, and Shake Shack still hold significant downside.

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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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