New Constructs®
Diligence | Independence | Performance

FEATURED STOCKS
4/13/22

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

March Performance Recap

Our Most Attractive Stocks (-4.1%) underperformed the S&P 500 (+5.0%) from March 3, 2022 through April 4, 2022 by 9.1%. The best performing large cap stock gained 21% and the best performing small cap stock was up 23%. Overall, 6 out of the 20 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (+1.8%) outperformed the S&P 500 (+5.0%) as a short portfolio from March 3, 2022 through April 4, 2022 by 3.2%. The best performing large cap short stock fell by 11%, and the best performing small cap short stock fell by 13%. Overall, 12 out of the 19 Most Dangerous stocks outperformed the S&P 500 as shorts.

The Most Attractive/Most Dangerous Model Portfolios underperformed as an equal-weighted long/short portfolio by 3.0%.

Buy the Most Attractive Stocks Model Portfolio for April

Buy the Most Dangerous Stocks Model Portfolio for April

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.

Twenty-five new stocks made our Most Attractive list this month, and 17 new stocks fell onto the Most Dangerous list. April's Most Attractive and Most Dangerous stocks were made available to members on April 6, 2022.

Our Most Attractive stocks all have 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.

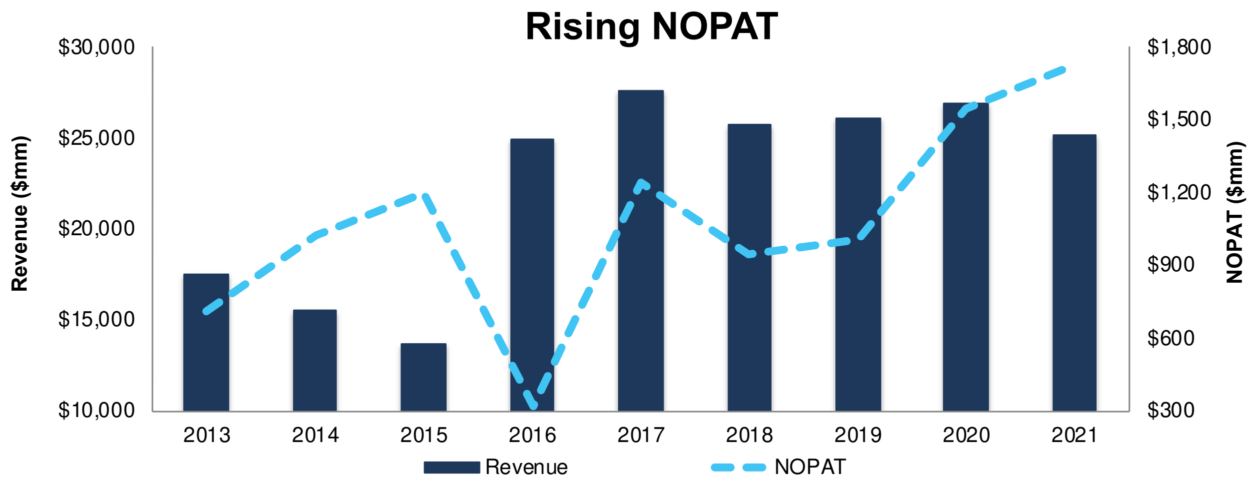
Most Attractive Stocks Feature for April: Nokia Corporation (NOK: $5/share)

Nokia Corporation (NOK) is the featured stock from April's Most Attractive Stocks Model Portfolio.

Nokia has grown revenue by 5% compounded annually and net operating profit after-tax (NOPAT) by 12% compounded annually since 2013. More recently, the company's NOPAT margin increased from 4% in 2018 to 7% in 2021, while invested capital turns rose from 1.2 to 1.6 over the same time. Rising NOPAT margins and invested capital turns drove Nokia's ROIC from 4% in 2018 to 11% in 2021.

[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 2013



Sources: New Constructs, LLC and company filings

Nokia Is Undervalued

At its current price of $5/share, NOK has a price-to-economic book value (PEBV) ratio of 0.6. This ratio means the market expects Nokia's NOPAT to permanently decline by 40%. This expectation seems overly pessimistic for a company that has grown NOPAT by 6% compounded annually since 2015.

Even if Nokia's NOPAT margin falls to 6% (equal to three-year average, compared to 7% in 2021) and the company's NOPAT declines by less than 1% compounded annually for the next decade, the stock is worth ~$7/share today – a 40% upside. See the math behind this reverse DCF scenario. Should Nokia 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 Nokia's 20-F:

Income Statement: we made $1.8 billion in adjustments, with a net effect of removing $105 million in non-operating income (<1% of revenue). Clients can see all adjustments made to Nokia's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $27.8 billion in adjustments to calculate invested capital with a net decrease of $14.6 billion. One of the most notable adjustments was $5.2 billion in other comprehensive income. This adjustment represented 17% of reported net assets. Clients can see all adjustments made to Nokia's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

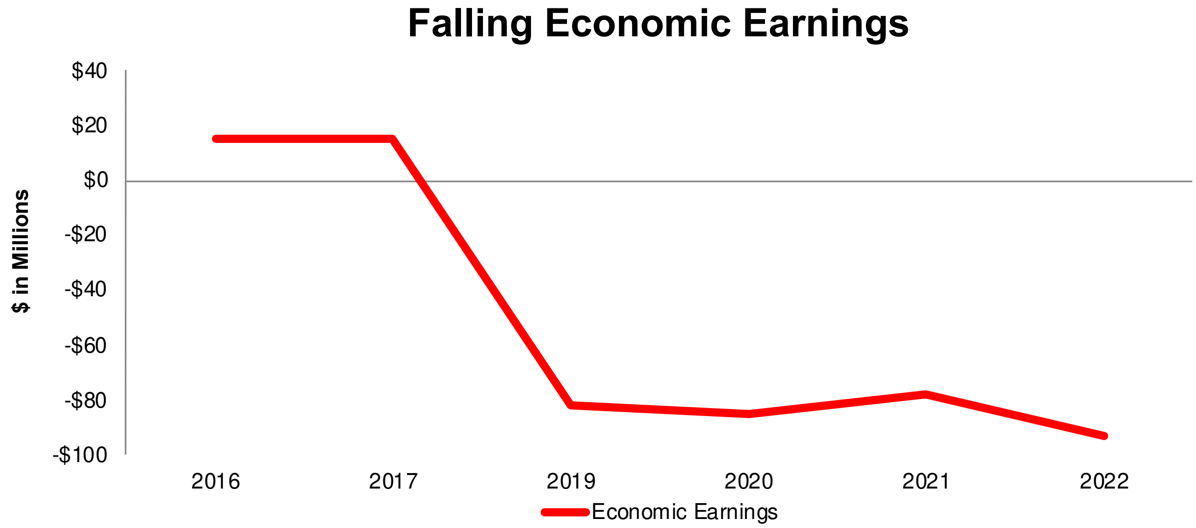
Valuation: we made $21.8 billion of adjustments with a net effect of increasing shareholder value by $8.2 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $10.1 billion in excess cash. This adjustment represents 34% of Nokia's market cap. Clients can see all adjustments to Nokia's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Dycom Industries, Inc. (DY: $95/share)

Dycom Industries, Inc. (DY) is the featured stock from April's Most Dangerous Stocks Model Portfolio.

Dycom's economic earnings, the true cash flows of the business, fell from $15 million in fiscal 2016 (FYE is 1/29/22) to -$93 million in fiscal 2022. The company's NOPAT margin fell from 6% to 2%, while invested capital turns fell from 1.6 to 1.5 over the same time. Falling NOPAT margins and invested capital turns drove Dycom's ROIC from 9% in fiscal 2016 to 3% in fiscal 2022.

Figure 2: Economic Earnings Since Fiscal 2016



Sources: New Constructs, LLC and company filings

Dycom Provides Poor Risk/Reward

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

To justify its current price of $95/share, Dycom must improve its NOPAT margin to 4% (10-year average, compared to 2% in fiscal 2022) and grow revenue by 11% compounded annually for the next decade. See the math behind this reverse DCF scenario. In this scenario, Dycom grows NOPAT by 18% compounded annually over the next ten years. Given that Dycom's NOPAT fell 16% compounded annually over the past five years, we think these expectations are overly optimistic.

Even if Dycom can achieve a NOPAT margin of 3% (three-year high) and grow revenue by 8% compounded annually for the next decade, the stock is worth just $42/share today – a 55% downside to the current stock price. See the math behind this reverse DCF scenario. Should Dycom's revenue grow at a slower rate, the stock has even more downside.

Each of these scenarios also assumes Dycom can grow revenue, NOPAT, and FCF without increasing working capital or fixed assets. This assumption is unlikely but allows us to create truly 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 Dycom's 10-K:

Income Statement: we made $56 million in adjustments, with a net effect of removing $16 million in non-operating expenses (<1% of revenue). Clients can see all adjustments made to Dycom's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $588 million in adjustments to calculate invested capital with a net increase of $257 million. One of the most notable adjustments was $226 million in asset write-downs. This adjustment represented 13% of reported net assets. Clients can see all adjustments made to Dycom's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $1.1 billion in adjustments, with a net decrease to shareholder value of $816 million. Apart from total debt, the most notable adjustment to shareholder value was $154 million in excess cash. This adjustment represents 6% of Dycom's market cap. Clients can see all adjustments to Dycom's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

This article originally published on April 13, 2022.

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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