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

May Performance Recap

Our Most Attractive Stocks (-6.8%) underperformed the S&P 500 (-3.9%) from May 4, 2022 through May 31, 2022 by 2.9%. The best performing large cap stock gained 5% and the best performing small cap stock was up 13%. Overall, 16 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-1.8%) underperformed the S&P 500 (-3.9%) as a short portfolio from May 4, 2022 through May 31, 2022 by 2.1%. The best performing large cap short stock fell by 22%, and the best performing small cap short stock fell by 24%. Overall, 12 out of the 33 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 5.0%.

This report leverages our cutting-edge Robo-Analyst technology to deliver proven-superior[1] fundamental research and support more cost-effective fulfillment of the fiduciary duty of care.

Seventeen new stocks made our Most Attractive list this month, and 22 new stocks also fell onto the Most Dangerous list. June's Most Attractive and Most Dangerous stocks were made available to members on June 2, 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.

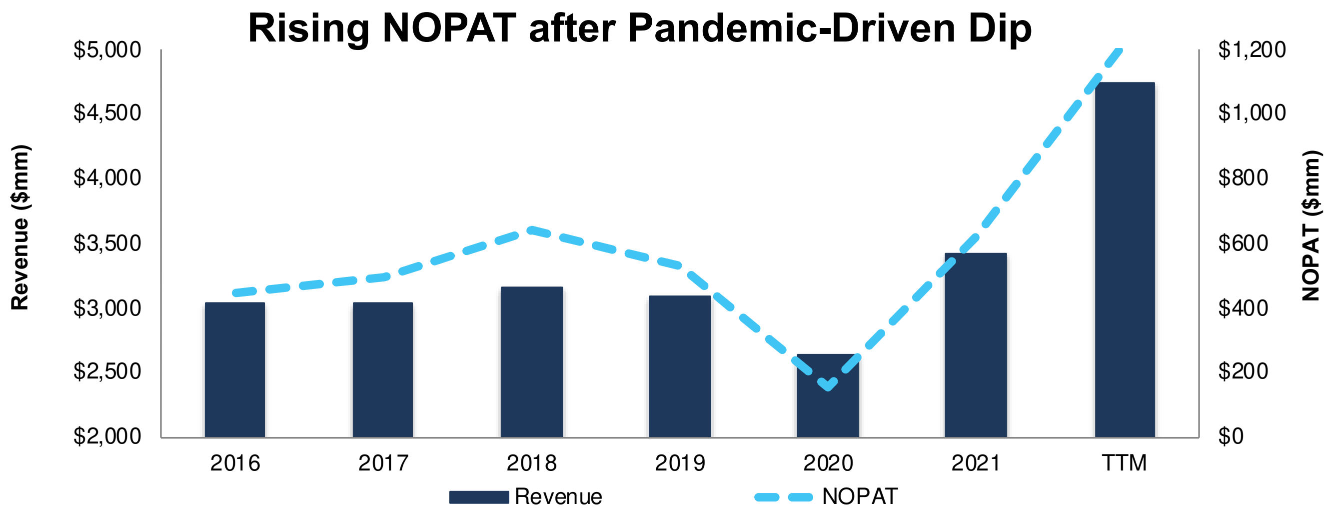
Most Attractive Stocks Feature for June: H&R Block, Inc. (HRB: $36/share)

H&R Block, Inc. (HRB) is the featured stock from June's Most Attractive Stocks Model Portfolio.

H&R Block has grown revenue by 2% compounded annually and net operating profit after-tax (NOPAT) by 7% compounded annually over the past five years. The company's NOPAT fell to $156 million during the COVID-19 pandemic in fiscal 2020 (FYE is 4/30) but has since recovered to $1.2 billion over the trailing twelve months (TTM). H&R Block's NOPAT margin has increased from 15% in fiscal 2016 to 26% TTM, while invested capital turns rose from 1.0 to 1.7 over the same time. Rising NOPAT margins and invested capital turns drive the company's return on invested capital (ROIC) from 14% in fiscal 2016 to 43% TTM.

[1] Our research utilizes our Core Earnings, a more reliable measure of profits, as proven in Core Earnings: New Data & Evidence, written by professors at Harvard Business School (HBS) & MIT Sloan and published in The Journal of Financial Economics.

Figure 1: Revenue & NOPAT Since Fiscal 2016



Sources: New Constructs, LLC and company filings

H&R Block Is Undervalued

At its current price of $36/share, HRB has a price-to-economic book value (PEBV) ratio of 0.3. This ratio means the market expects H&R Block's NOPAT to permanently decline by 70%. This expectation seems overly pessimistic for a company that grew NOPAT by 7% compounded annually over the past five years and 4% compounded annually over the past ten years.

Even if H&R Block's NOPAT margin falls to 15% (equal to 20-year average, compared to 26% TTM) and the company's NOPAT declines by 1% compounded annually for the next decade, the stock is worth $57/share today – a 58% upside. See the math behind this reverse DCF scenario. Should H&R Block 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 H&R Block's 10-Qs and 10-K:

Income Statement: we made $244 million in adjustments, with a net effect of removing $43 million in non-operating expense (1% of revenue). Clients can see all adjustments made to H&R Block's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $1.7 billion in adjustments to calculate invested capital with a net decrease of $244 million. One of the most notable adjustments was $735 million in asset write-downs. This adjustment represented 30% of reported net assets. Clients can see all adjustments made to H&R Block's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

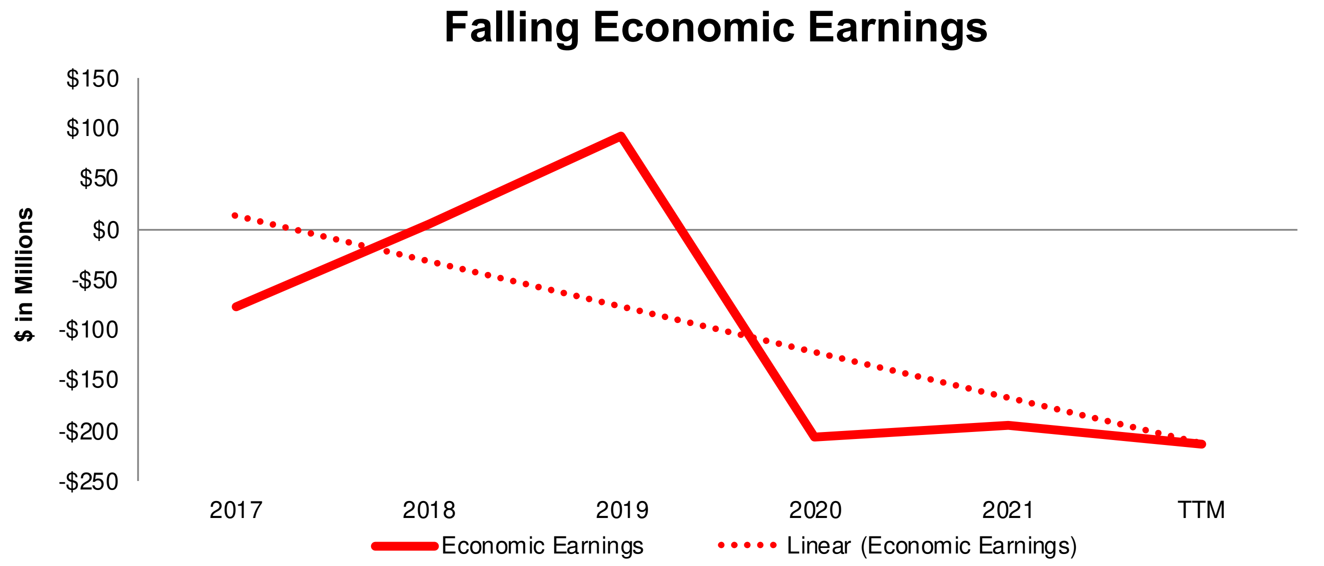
Valuation: we made $3.2 billion of adjustments with a net effect of decreasing shareholder value by $1.6 billion. One of the most notable adjustments to shareholder value was $805 million in excess cash. This adjustment represents 14% of H&R Block's market cap. Clients can see all adjustments to H&R Block's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Light & Wonder Inc (LNW: $56/share)

Light & Wonder Inc (LNW) is the featured stock from June's Most Dangerous Stocks Model Portfolio.

Light & Wonder's economic earnings, the true cash flows of the business, have fallen from -$76 million in 2017 to -$213 million over the TTM. The company's NOPAT margin has fallen from 13% to 8%, while invested capital turns fell from 0.4 to 0.3 over the same time. Falling NOPAT margins and invested capital turns drive Light & Wonder's ROIC from 5% in 2017 to 2% TTM.

Figure 2: Economic Earnings Since 2017



Sources: New Constructs, LLC and company filings

Light & Wonder Provides Poor Risk/Reward

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

To justify its current price of $56/share, Light & Wonder must improve its NOPAT margin to 17% (all-time high in 2019, compared to 8% TTM) and grow revenue by 7% compounded annually for the next decade. See the math behind this reverse DCF scenario. In this scenario, Light & Wonder grows NOPAT by 15% compounded annually over the next ten years. Given that Light & Wonder's NOPAT has fallen 72% since 2019, we think these expectations look overly optimistic.

Even if Light & Wonder can achieve a NOPAT margin of 12% (five-year average) and grow revenue by 6% compounded annually for the next decade, the stock is worth just $8/share today – an 86% downside to the current stock price. See the math behind this reverse DCF scenario. Should Light & Wonder's revenue grow at a slower rate, the stock has even more downside.

Each of these scenarios also assumes Light & Wonder 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 Light & Wonder's 10-Qs and 10-K:

Income Statement: we made $1.6 billion in adjustments, with a net effect of removing $189 million in non-operating income (9% of revenue). Clients can see all adjustments made to Light & Wonder's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $5.9 billion in adjustments to calculate invested capital with a net increase of $333 million. One of the most notable adjustments was $2.3 billion in net assets from discontinued operations. This adjustment represented 33% of reported net assets. Clients can see all adjustments made to Light & Wonder's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $11.4 billion in adjustments, with a net decrease to shareholder value of $7.3 billion. Apart from total debt and the net assets from discontinued operations mentioned above, the most notable adjustment to shareholder value was $396 million in excess cash. This adjustment represents 7% of Light & Wonder's market cap. Clients can see all adjustments to Light & Wonder's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

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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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