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POSITION UPDATE 6/29/22

Position Close Update: Zendesk (ZEN)

Zendesk Inc. (ZEN: $75/share) – Closing Short Position – up 65% vs. S&P up 40%

We first put Zendesk in the Danger Zone in March 2018 and reiterated our opinion on the stock in January 2019, March 2020, and August 2021. ZEN earned an Unattractive rating at the time of our first report. We pointed out that Zendesk's strong revenue growth had not created any profits, its profitability lagged peers, and its stock was significantly overvalued.

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.

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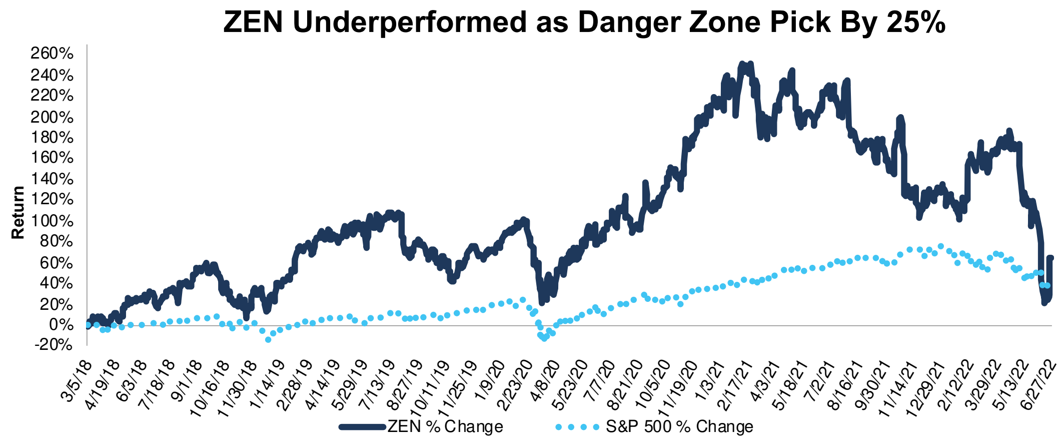
During the 4+ year holding period, and after the recent acquisition announcement, ZEN underperformed as a short position, rising 65% compared to a 40% gain for the S&P 500. Developments over the life of the trade highlight the difficulty of picking shorts in a market awash in cheap capital.

Zendesk's return on invested capital (ROIC) fell from -28% in 2017 to -38% over the trailing-twelve-months (TTM), and Core Earnings fell from -$115 million to -$239 million over the same time. Per Figure 1, the market had begun to ring the warning bell on ZEN, and prior to the take-private announcement, our Zendesk Danger Zone pick had outperformed the S&P 500 as a short by 11%.

However, despite a clear deterioration of the company's fundamentals, Zendesk announced on June 24, 2022 that a private equity investor group led by Permira and Hellman & Friedman had made an unsolicited bid of $10.2 billion, or $77.50/share, which represents a 34% premium to the stock's closing price the day prior to the announcement. Ironically, management rejected a prior bid of ~$130/share back in February 2022.

The acquisition of an unprofitable business highlights the stupid money risk, which is one of the biggest risks to any short thesis. Despite announcing in early June that it would remain an independent company, Zendesk agreeing to be acquired turned a winning Danger Zone pick into a losing pick. We're closing this Danger Zone pick since there is little to stop the announced deal from going through, as Bloomberg reports the deal is already fully financed, and activist investor Jana Partners has since withdrawn its ongoing proxy battle.

Figure 1: ZEN vs. S&P 500 – Price Return – Unsuccessful Danger Zone Pick



Sources: New Constructs, LLC and company filings
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

[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.

This article originally published on [June 29, 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.

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