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

August Performance Recap

Our Most Attractive Stocks (-4.6%) outperformed the S&P 500 (-4.8%) from August 3, 2022 through August 31, 2022 by 0.2%. The best performing large cap stock gained 7% and the best performing small cap stock was up 26%. Overall, 22 out of the 40 Most Attractive stocks outperformed the S&P 500.

Our Most Dangerous Stocks (-2.6%) underperformed the S&P 500 (-4.8%) as a short portfolio from August 3, 2022 through August 31, 2022 by 2.2%. The best performing large cap short stock fell by 24%, and the best performing small cap short stock fell by 22%. Overall, 19 out of the 36 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 2.0%.

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.

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

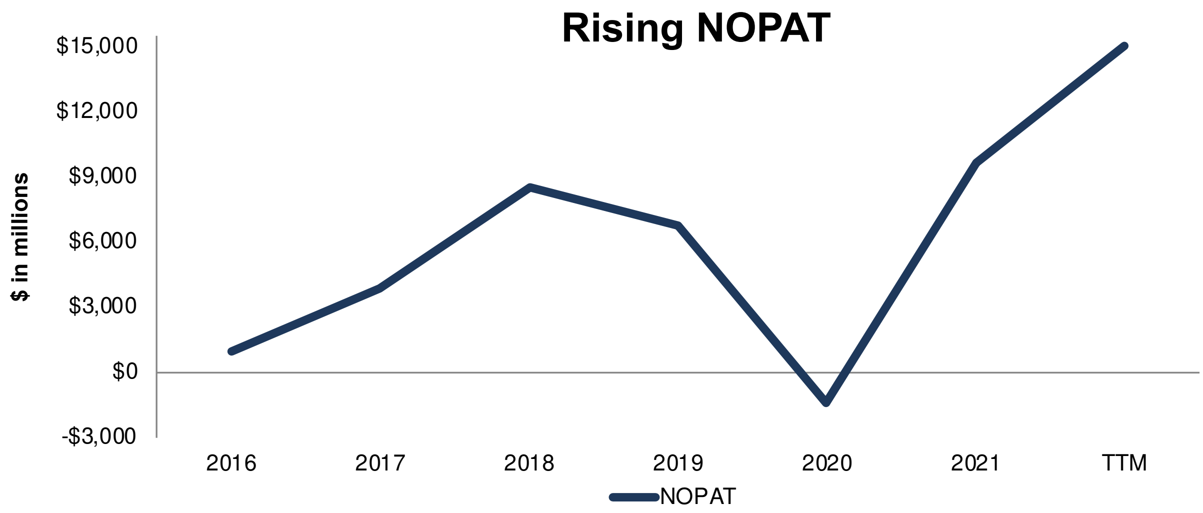
Most Attractive Stocks Feature for September: Eni SpA (E: $23/share)

Eni is the featured stock from September's Most Attractive Stocks Model Portfolio.

Eni has grown net operating profit after-tax (NOPAT) by 60% compounded annually over the past five years. Eni's NOPAT margin has increased from 1.5% in 2016 to 13% over the trailing-twelve-months (TTM), while invested capital turns rose from 0.6 to 1.2 over the same time. Rising NOPAT margins and invested capital turns drive the company's return on invested capital (ROIC) from 1% in 2016 to 15% over the 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: NOPAT Since 2016



Sources: New Constructs, LLC and company filings

Eni Is Undervalued

At its current price of $23/share, E has a price-to-economic book value (PEBV) ratio of 0.1. This ratio means the market expects Eni's NOPAT to permanently decline by 90%. This expectation seems overly pessimistic for a company that grew NOPAT by 60% compounded annually over the past five years.

Even if Eni's NOPAT margin falls to its 10-year average of 5% (vs. 13% TTM) and NOPAT falls 8% compounded annually for the next decade, the stock would be worth $35+/share today – a 52% upside. See the math behind this reverse DCF scenario. Should Eni 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 made based on Robo-Analyst findings in Eni's 10-Qs and 10-Ks:

Income Statement: we made $12.1 billion in adjustments, with a net effect of removing $3.1 billion in non-operating expenses (4% of revenue). Clients can see all adjustments made to Eni's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $47.5 billion in adjustments to calculate invested capital with a net decrease of $3.1 billion. One of the most notable adjustments was $16.5 million in asset write-downs. This adjustment represented 15% of reported net assets. Clients can see all adjustments made to Eni's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

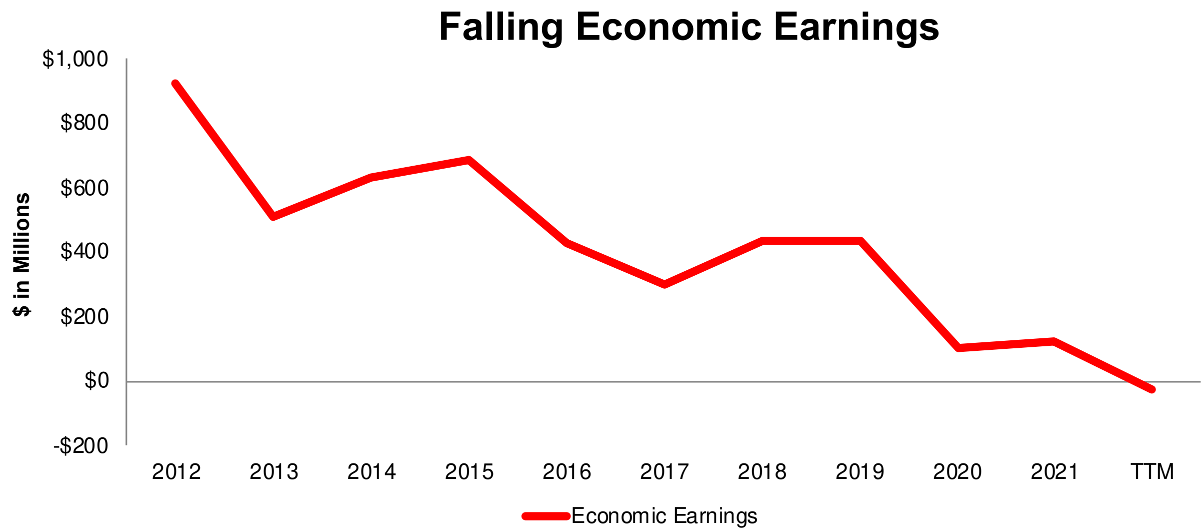
Valuation: we made $44.8 billion of adjustments with a net effect of decreasing shareholder value by $20.0 billion. Apart from total debt, the most notable adjustment to shareholder value was $6.7 billion in excess cash. This adjustment represents 16% of Eni's market cap. Clients can see all adjustments to Eni's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Most Dangerous Stocks Feature: Eaton Corporation PLC (ETN: $143/share)

Eaton Corporation PLC (ETN) is the featured stock from September's Most Dangerous Stocks Model Portfolio.

Since its acquisition of Cooper Industries, Eaton's economic earnings, the true cash flows of the business, have fallen from $922 million in 2012 to -$22 million over the TTM. Eaton's NOPAT margin has fallen from 10.9% to 10.5%, while invested capital turns fell from 0.9 to 0.6 over the same time. Falling NOPAT margins and invested capital turns drive Eaton's ROIC from 10% in 2016 to 6% TTM.

Figure 2: Economic Earnings Since 2012



Sources: New Constructs, LLC and company filings

Eaton Provides Poor Risk/Reward

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

To justify its current price of $143/share, Eaton must improve its NOPAT margin to 13% (all-time high compared to 11% TTM) and grow NOPAT by 10% compounded annually for the next ten years. See the math behind this reverse DCF scenario. Given that Eaton's NOPAT fell 3% compounded annually over the past five years, we think these expectations are overly optimistic.

Even if Eaton can maintain its TTM NOPAT margin of 11% and grow NOPAT by 5% compounded annually for the next decade, the stock would be worth no more than $80/share today – a 44% downside to the current stock price. See the math behind this reverse DCF scenario.

Each of these scenarios also assumes Eaton 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 made based on Robo-Analyst findings in Eaton's 10-Qs and 10-Ks:

Income Statement: we made $1 billion in adjustments, with a net effect of removing $204 million in non-operating income (1% of revenue). Clients can see all adjustments made to Eaton's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $8.6 billion in adjustments to calculate invested capital with a net increase of $4.6 billion. One of the most notable adjustments was $3.6 billion in other comprehensive income. This adjustment represented 14% of reported net assets. Clients can see all adjustments made to Eaton's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $11.2 billion in adjustments, with a net decrease to shareholder value of $11.2 billion. Apart from total debt, the most notable adjustment to shareholder value was $963 million in underfunded pensions. This adjustment represents 2% of Eaton's market cap. Clients can see all adjustments to Eaton's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

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Disclosure: David Trainer, Kyle Guske II, Matt Shuler, and Brian Pellegrini 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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