

September 6, 2021

## Suspicious Overearners:

This model seeks companies that are potentially “over-earning”, defined as companies with **unusually high margins relative to their own history or relative to the industry.**

Margin over-earners are fertile hunting ground for shorts if the reasons for the margin increase are either unsustainable or fraudulent. In addition to margin sustainability, a critical judgement involves to what extent unsustainable margins are embedded in a company’s forecasts.

These shorts tend to have moderate to higher betas, higher valuations due to recent strong results and good short responses to subsequently disappointing earnings.



Companies highlighted in yellow are discussed below as potential shorts.

6-Sep-21

## Suspicious Overearners: Spikes in Gross Margin

Ticker	Name (flags)		Market Cap (\$mns)	ADDV (\$mns)	Price (\$)	Days to Cover	Gross Margins				Unusual Rises in:		
							5Y Avg	2Y Avg	LTM	5Yrs	Inven.	A/R	3thCurrA
CWT	California Water Service	Utilities	3,356	10	64.82	5	36.5%	36.3%	40.6%		-	-	-
DKS	Dick's Sporting Goods, In	Retail Trade	9,243	348	144.39	9	30.0%	31.1%	36.6%		-	-	-
DFIN	Donnelley Financial Solut	Technology Services	1,127	6	33.34	2	35.0%	37.2%	47.1%		-	-	-
HZO	MarineMax, Inc.	Retail Trade	1,061	12	48.74	13	25.8%	27.1%	30.1%		-	-	-
GES	Guess?, Inc.	Consumer Non-Durables	1,576	17	23.52	10	36.1%	37.7%	43.1%		-	-	-
NUE	Nucor Corporation	Non-Energy Minerals	33,857	447	114.81	1	13.6%	12.9%	20.5%		√	-	-
CWH	Camping World Holdings, I	Retail Trade	1,848	43	39.91	6	28.0%	28.4%	33.3%		-	-	-
OMI	Owens & Minor, Inc.	Distribution Services	2,948	29	38.94	5	13.0%	13.9%	16.0%		√	-	-
ATKR	Atkore Inc	Producer Manufacturing	4,257	45	91.61	2	24.7%	27.8%	35.6%		-	-	-
HCA	HCA Healthcare Inc	Health Services	81,086	272	253.65	3	15.0%	14.8%	16.8%		-	-	-
MDU	MDU Resources Group Inc	Utilities	6,599	29	32.31	2	13.0%	13.3%	14.0%		-	-	-
DOV	Dover Corporation	Producer Manufacturing	25,330	126	175.88	2	37.0%	37.2%	38.0%		-	-	-
MAR	Marriott International, I	Consumer Services	44,094	267	132.94	2	15.7%	16.3%	23.3%		-	√	-
LPX	Louisiana-Pacific Corpora	Non-Energy Minerals	6,036	87	64.02	4	23.8%	24.6%	45.7%		-	-	-
BKE	Buckle, Inc.	Retail Trade	1,985	25	39.66	13	42.2%	43.7%	49.0%		-	-	-
LEVI	Levi Strauss & Co. Class	Consumer Non-Durables	2,433	38	26.54	2	53.2%	54.3%	56.5%		-	-	-
DAR	Darling Ingredients Inc.	Process Industries	12,084	100	73.42	2	13.7%	14.8%	18.0%		-	-	-
BCC	Boise Cascade Co.	Non-Energy Minerals	2,266	20	58.26	2	12.8%	14.6%	19.6%		-	-	-
AZPN	Aspen Technology, Inc.	Technology Services	8,782	53	131.20	4	90.1%	90.3%	91.5%		-	-	-
CROX	Crocs, Inc.	Consumer Non-Durables	8,645	122	139.05	3	50.1%	52.6%	57.9%		-	-	-
CPRT	Copart, Inc.	Commercial Services	34,318	127	145.66	3	43.9%	45.1%	49.1%		-	-	-
MTH	Meritage Homes Corporatio	Consumer Durables	4,196	32	109.29	5	19.1%	20.7%	24.1%		-	-	-
LKQ	LKQ Corporation	Consumer Durables	15,188	69	50.68	4	36.6%	37.0%	38.1%		-	-	-
DHR	Danaher Corporation	Health Technology	236,608	613	332.35	4	55.7%	56.3%	59.2%		-	-	-
HOLX	Hologic, Inc.	Health Technology	20,360	106	80.26	3	53.9%	58.1%	68.1%		-	-	-
LAD	Lithia Motors, Inc.	Retail Trade	9,875	97	325.68	5	14.9%	15.6%	16.9%		-	-	-
FLO	Flowers Foods, Inc.	Consumer Non-Durables	5,135	29	24.02	8	45.1%	45.7%	46.9%		-	-	-

Dick's Sporting Goods, In (DKS), Retail Trade,

Dick's Sporting Goods, Inc. engages in the retail of extensive assortment of authentic sports equipment, apparel, footwear, and accessories.

- Sales growth recovered sharply after the Covid plunge. The May 2021 quarter delivered +119% growth (now moderated to +20.7%).
- Gross margins had declined from 31% in 2012 to 27% pre-pandemic, but now spiked to 36.6% LTM. EBITDA margins rose from 6.7% pre-pandemic to 17% now. EBITDA more than doubled to \$2bn.
- Operating leverage pushed incremental gross margins to 66%, on an LTM basis.
- The company burned off excess inventory held in the pandemic (a positive).
- Estimates have been raised this year, sharply in May and again last month.
- Estimates have sales declining -13% in the April 2022 quarter, off a very strong prior year quarter, then returning to mid-single digit growth thereafter.
- The stock is up 153% YTD and 7x where it was in April 2020.
- The stock looks somewhat expensive on an earning basis, based on sky-high margins. On an EV/S basis, the stock has never been more expensive, trading fully 2.3 standard deviations rich to its history.

- The share count has been increased by 25% over 18 months.

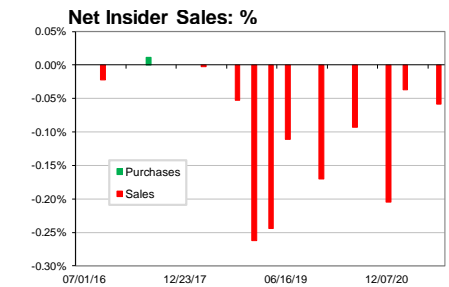
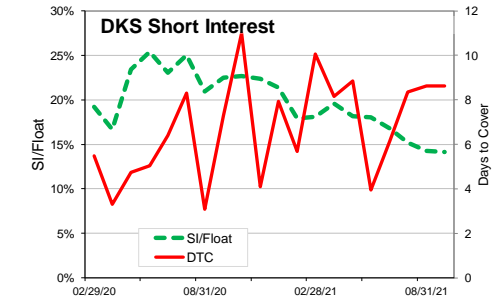
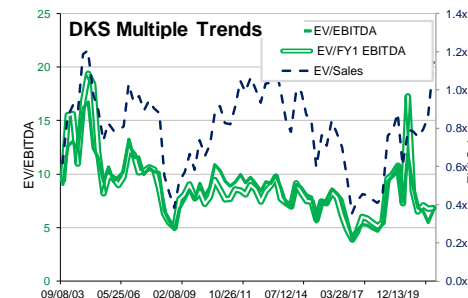
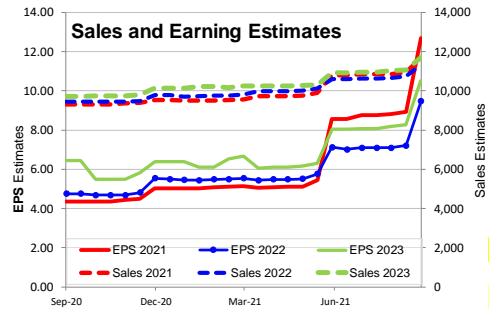
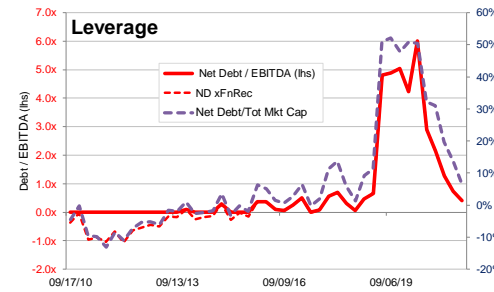
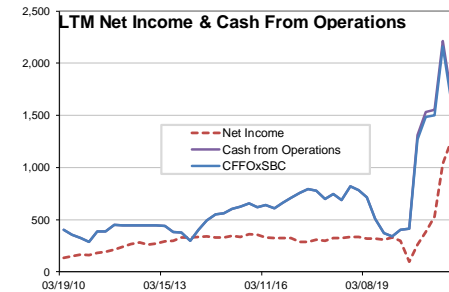
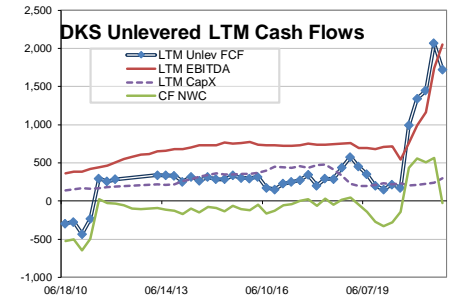
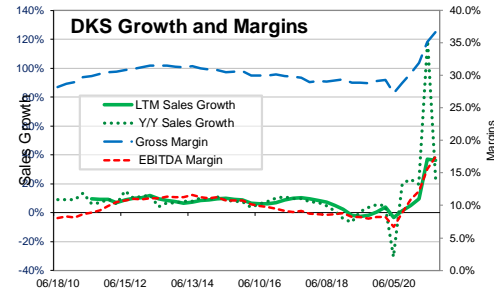
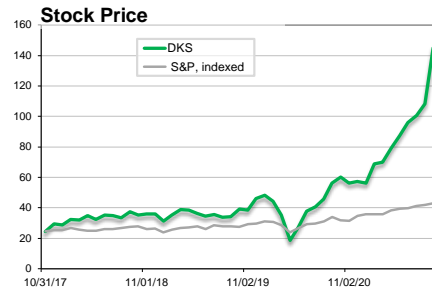
### Dick's Sporting Goods, Inc. (DKS)

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$12.6 bn; Daily Volume: \$431mn; Price: \$145.19

earnings: 30-Nov

updated: 3-Sep



Nucor Corporation (NUE), Non-Energy Minerals,

Nucor manufactures carbon and alloy steel in sheet, bar and plate. Also producing steel joists and deck, rebar, fasteners, and building systems.

- The company made two acquisitions in August, for \$1.3bn.
- Sales are up sharply due to strong nonresidential construction, high selling prices and lean inventories across the channel.
- Margins reached levels not seen since 2007 and double what they were pre-pandemic (20% vs 10%, EBITDA) due to increased metal margin in the steel mills segment
- Incremental gross profit has been very high over the past three quarters.
- Forecasts have sales slowing sharply and even declining 20% off current growth rates, with margins following sales down.
- Estimates have been rising since December.
- The stock is up +114%, this year and trades at a new high.
- The stock trades at high multiples of sales and earnings, even based on unusually high recent sales and margins. The stock trades at 19x 2023 earnings vs a three year average of 13x FY3.
- Insiders have been selling more aggressively.
- Short interest is low.

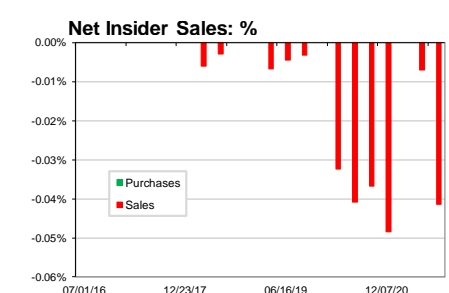
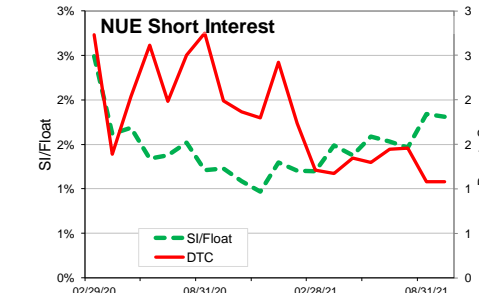
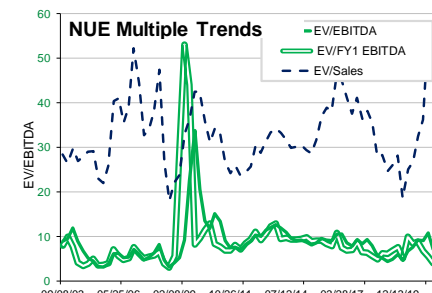
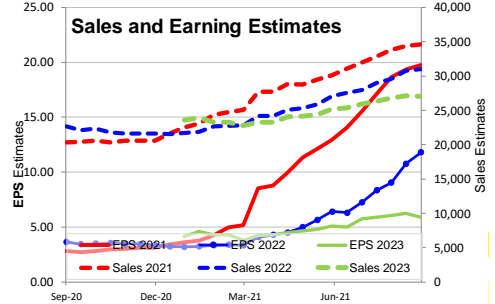
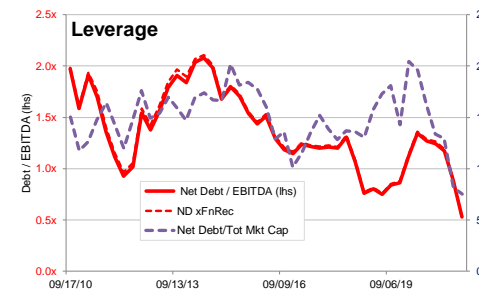
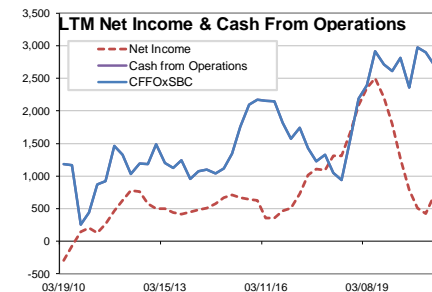
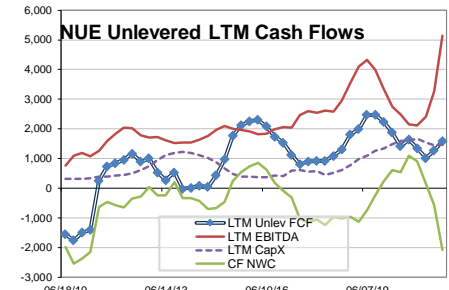
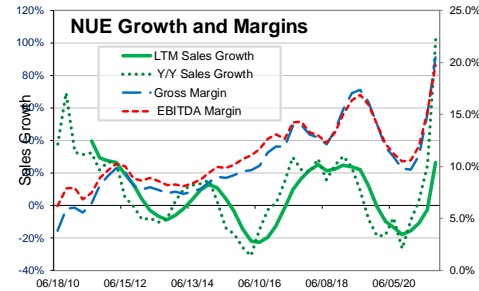
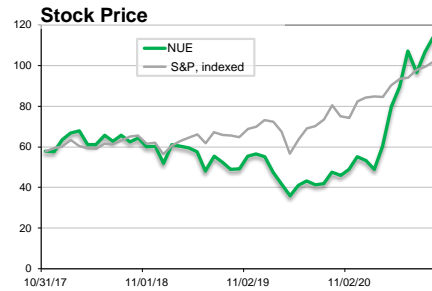
**Nucor Corporation (NUE)**

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$33.5 bn; Daily Volume: \$431mn; Price: \$114.05

earnings: 21-Oct

updated: 3-Sep



Atkore Inc (ATKR), Producer Manufacturing,

Atkore manufactures electrical raceway products that isolate, and protect electrical circuitry and products that support, and secure component parts in electrical, industrial, and construction applications.

- Sales have increased 122% over the prior year primarily due to an increase in ASP of 89% and volume increase of 24%.
- ASPs increased with PVC prices for electrical conduit and fittings products. Pricing for PVC products is expected to drop, but timing is uncertain.
- Margins followed sales up and increased from 17% EBITDA to 27% EBITDA on a TTM basis. EBITDA rose from \$300mn TTM September 2020 to \$709mn TTM June 2021.
- Incremental gross margins rose to 66% last year.
- Forecasts expect sales growth to remain high, at +75% next quarter before dropping to sales declines of -24% by June 2022.
- Estimates continue to rise.
- The stock is up 121% YTD and has more than quadrupled since November 2020.
- Multiples are very high even based on inflated sales and earnings figures. The stock trades at 13x 2022 (FY September) earnings as compared to an FY2 average of 9x and 12.1x 2023 versus an FY3 average of 8.6x.

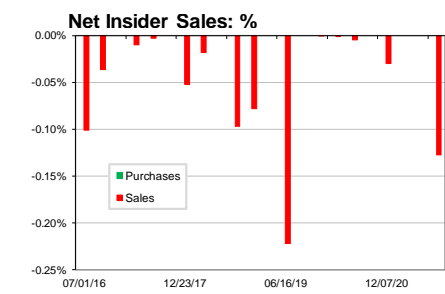
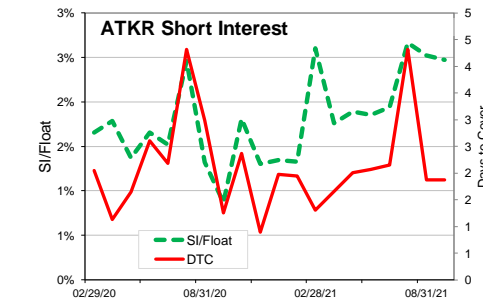
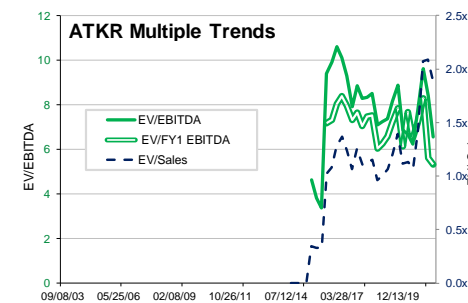
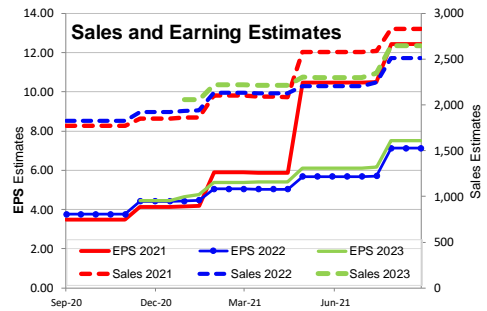
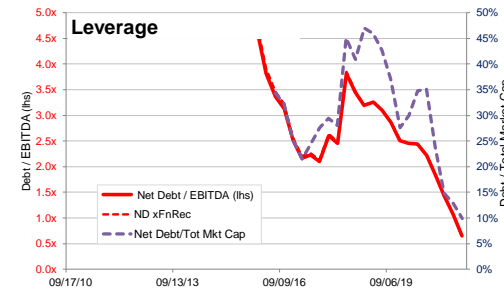
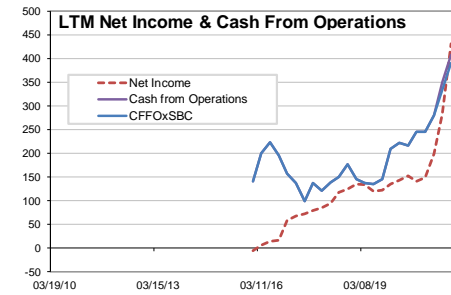
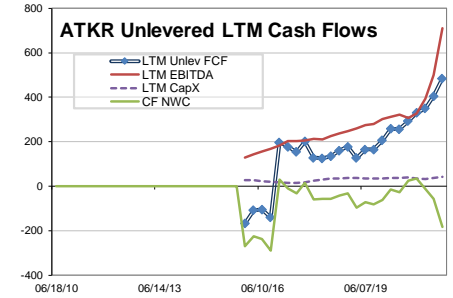
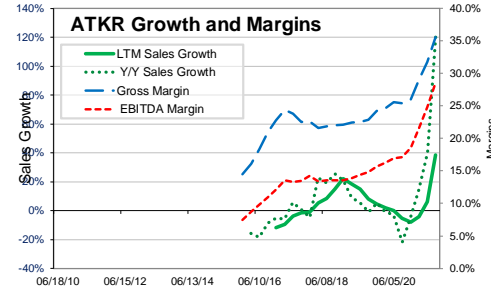
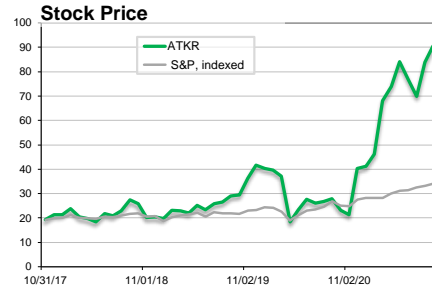
**Atkore Inc (ATKR)**

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$4.2 bn; Daily Volume: \$45mn; Price: \$90.74

earnings: 1-Dec

updated: 3-Sep





HCA Healthcare Inc (HCA), Health Services

HCA operates hospitals, freestanding surgery centers, emergency rooms, and urgent care centers.

- Sales have accelerated to +30% off an easy comparison to the prior year. Many deferred hospital procedures have come rushing back to HCA in the last quarter.
- Margins have risen sharply as well, given the high fixed cost nature of the hospital business. EBITDA margins had been declining since 2014, reaching a pre-covid level of 19%, only to spike to 21.7%, LTM.
- EBITDA margins have reached new highs looking back to at least 1993. Incremental gross margins are 36%, LTM, versus average gross margins of 15% (both include D&A).
- Forecasts have the company resuming the sales path that was in place pre-Covid, but do not foresee any margin reversion. Margins are expected to rise from these all time high levels.
- Estimates continue to rise
- The company posted a very strong beat last quarter.
- The stock is up 54% YTD and trades at 2.5x its Covid low from April 2020.
- The stock trades near peak earnings multiples and clearly higher than next-highest peak sales multiples. FY2/3 EBITDA and earnings multiples are very high despite the inflated margins.

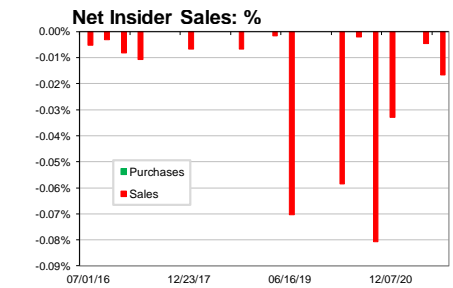
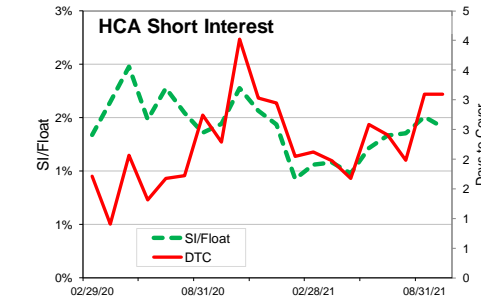
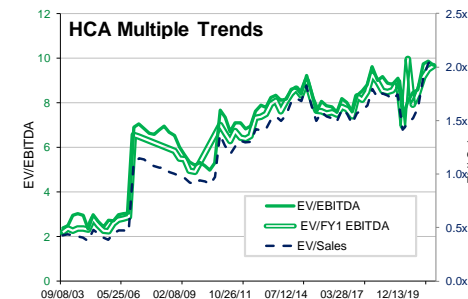
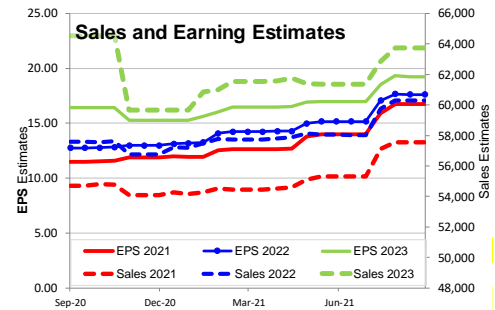
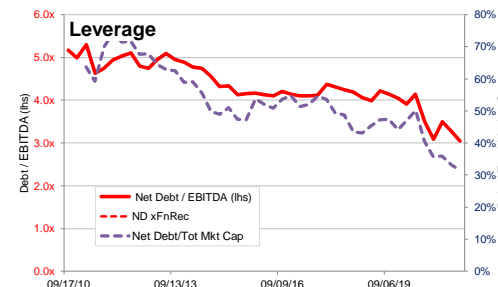
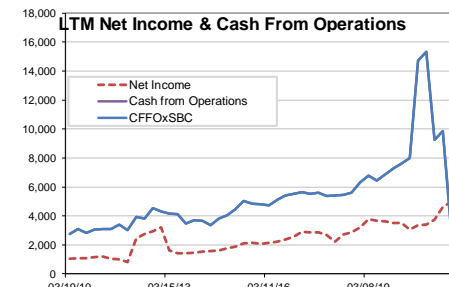
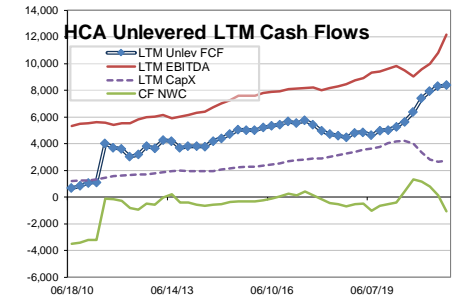
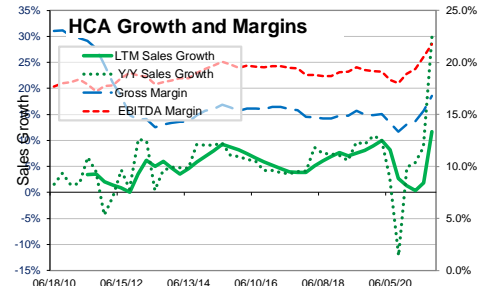
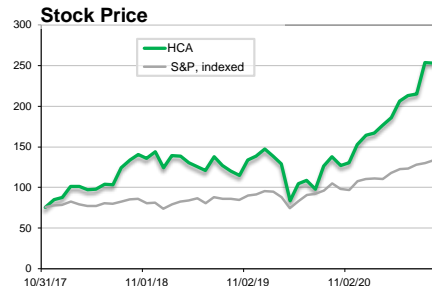
**HCA Healthcare Inc (HCA)**

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$81.0 bn; Daily Volume: \$271mn; Price: \$252.95

earnings: 2-Nov

updated 3-Sep



California Water Service (CWT), Utilities, California Water is a water utility in California, Washington, New Mexico, and Hawaii.

- Sales have accelerated to +21% from -2% a year ago. Both gross and EBITDA margins are spiking. EBITDA has hit a new high of 35% (more typically 25%-30%) and levels of \$300mn LTM.
- Sales/employee has hit a new high as well.
- Capex has consumed more than 100% of EBITDA since 2016.
- Leverage is moderate, at 4.2x EBITDA, based on record EBITDA and the company has no meaningful maturities until at least 2025.
- Forecasts have sales dropping -34% in the December quarter, then rising again but levelling off at roughly the levels they were through 2019.
- Estimates have been rising recently.
- The stock is up 20% YTD, 45% above an October low, and at a new high.
- The stock trades at all-time high multiples of sales, EBITDA and (almost) earnings. Recent margin highs have pushed CWT's stock to 17.6x 2021 EBITDA and 35.3x 2021 earnings.
- The stock yields 1.3% at current values.

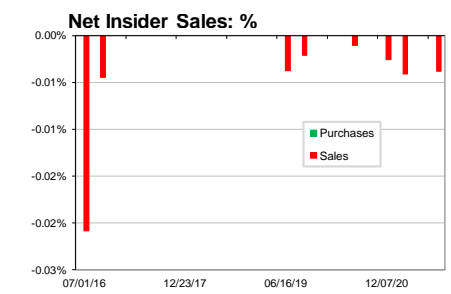
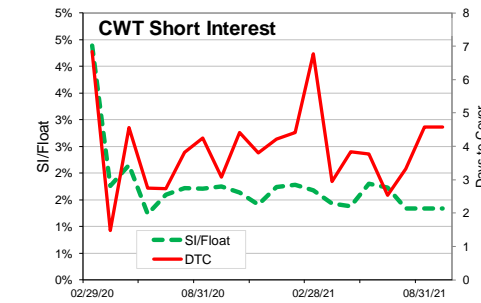
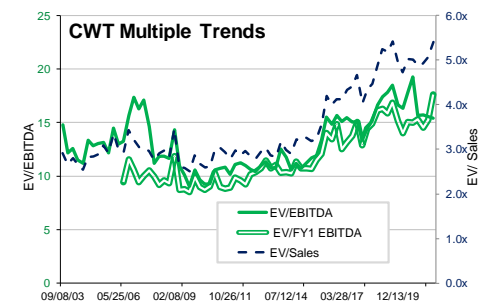
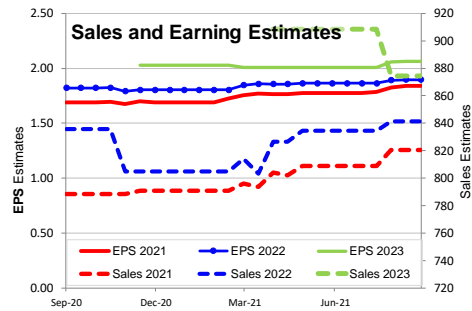
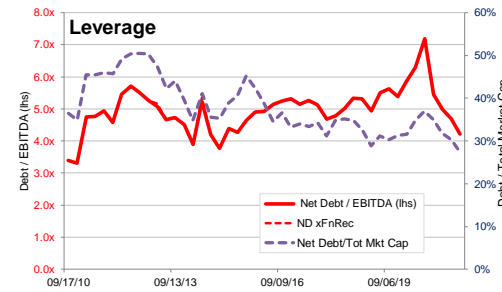
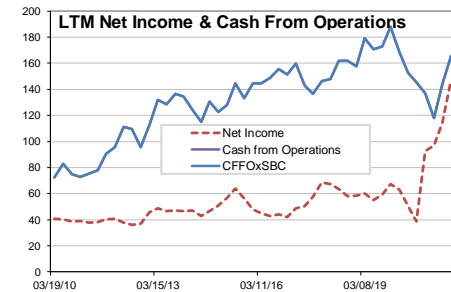
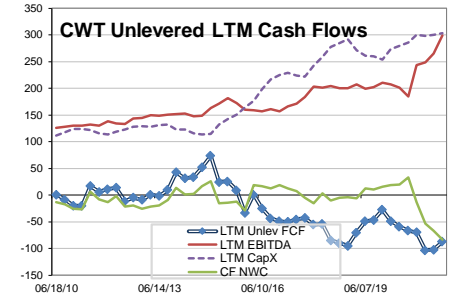
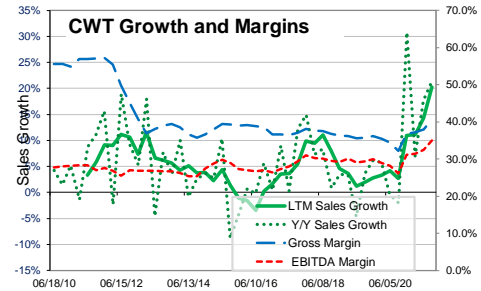
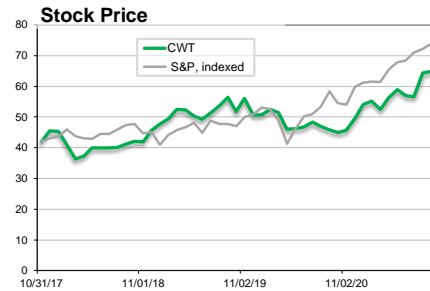
**California Water Service Group (CWT)**

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$3.4 bn; Daily Volume: \$10mn; Price: \$64.89

earnings: 28-Oct

updated: 3-Sep



Danaher Corporation (DHR), Health Technology,

Danaher designs, manufactures, and markets life science research tools, analytical instruments, reagents, consumables, software as well as environmental products and services.

- The company made a \$9bn acquisition in August (3.8% of market cap).
- Sales did not suffer much during Covid (-11%), but have since recovered to +57% in April and +36% in July 2021.
- Gross margins added 400bps from a steady 55% level that persisted for four years. EBITDA margins rose from 23% before Covid to 33% now. These are all-time highs by 800bps.
- Forecasts expect sales growth to drop back down to single digits by March. Margins are not expected to return to prior levels but remain (and rise from ) current records.
- Estimates continue to rise.
- The stock is at a new high and up 49% YTD.
- Multiples are at record highs dating back at least until 2003. Despite the recent run-up in sales, and record high margins, forward multiples are very high. The stock trades at 26x 2021 EBITDA (v 22x for its 3 year average), 25x 2022 (v 19x) and 24x 2023 (v 18x).

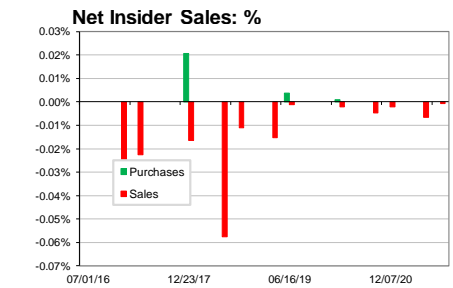
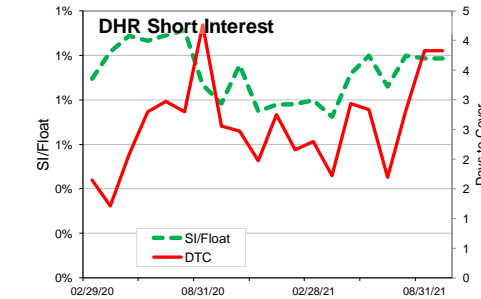
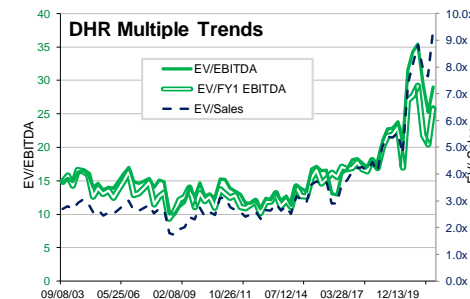
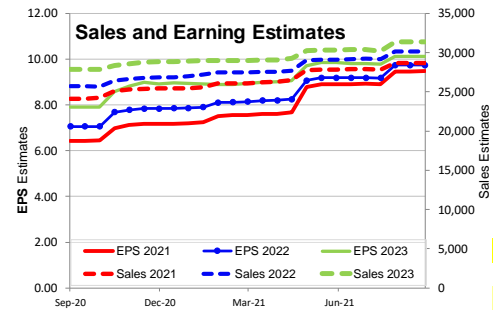
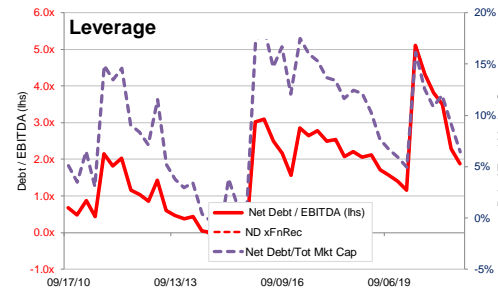
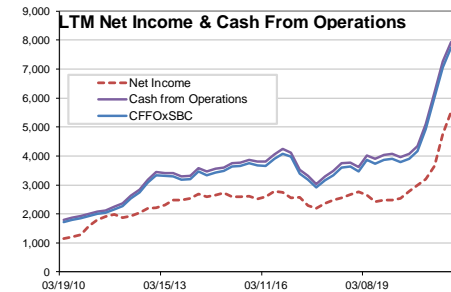
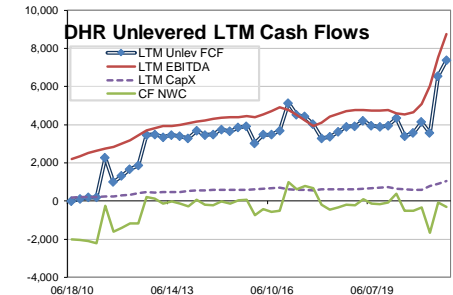
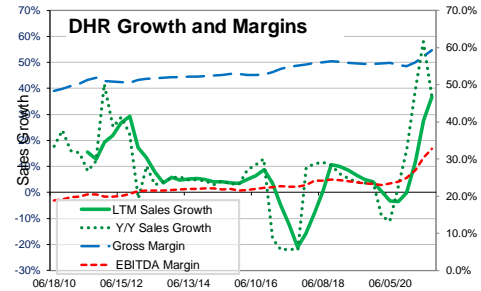
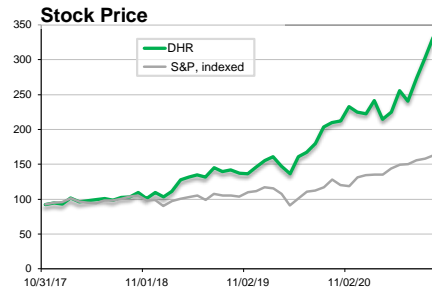
**Danaher Corporation (DHR)**

Historical Metrics: Sales, Margins, Cash Flow, Leverage, Valuation, Estimates & Short Interest

Market Cap: \$237.3 bn; Daily Volume: \$647mn; Price: \$332.43

earnings: 21-Oct

updated: 3-Sep





## About Two Rivers Analytics

Two Rivers is dedicated to providing actionable, high quality investment ideas, with an emphasis on short ideas, to institutional investors.

Our work uses a hybrid quantitative/qualitative process to identify companies at high risk of a declining equity price. Our quantitative screening process identifies multiple categories of risk to create this Stock at Risk ranking. The ranking is vetted further through a timing/catalyst analysis and a shortability assessment. The best short ideas are analyzed fundamentally and presented to clients.

For more information, including our process, influences and biographies, please visit [TwoRiversAnalytics.com](http://TwoRiversAnalytics.com).

### **Analyst Certification**

*I, Eric Fernandez, hereby certify that the views expressed in the foregoing research report accurately reflect my personal views about the subject securities and issuer(s) as of the date of this report. I further certify that no part of my compensation was, is or will be directly, or indirectly, related to the specific recommendations or views contained in this report. Neither I, nor a member of my household is an officer, director, or advisory board member of the issuer(s) or has another significant affiliation with the issuer(s) that is/are the subject of this research report. I do not know or have reason to know at the time of this publication of any other material conflict of interest.*

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