

IDENTIFYING UNDERVALUED COMPANIES IN THE STOCK MARKET.

INTRODUCTION

Finding a treasure at a garage sale gives a view of what an undervalued company is. It's referred as one whose stock price is lower than its actual worth. For instance, if a company's stock is trading at \$10, but its assets and earnings suggest it should be worth \$20, then the company is considered undervalued. This approach aims to capitalize on the difference between the current stock price and the company's genuine worth in the next 4 years by examining gross profit (GP) and gross profit growth (GPG) compared to similar peers in the same sector. While GP and GPG provides valuable insights into a company's profitability and growth. However, they do not account for how the market values these profits or the company's overall financial health. Other metrics are thereby essential to get a complete picture of a company's value.

Metrics such as Market Capitalization, Price-to-Earnings Ratio and Price-to-Book Ratio help in determining how the market perceives the company's worth compared to its actual performance. They provide insights into whether the stock is priced fairly relative to its earnings, assets and overall market value. Combining these metrics with GP and GPG ensures a more comprehensive valuation, capturing both the company's operational success and its valuation status. Materials by etmoney.com and stash.com helped in giving an extensive understanding on market valuation.

METHODOLOGY

Data Collection: Data on undervalued companies were retrieved from finviz.com platform. Financial Metrics on Market Capitalization (market cap.), Price-to-Earnings Ratio (P/E), Price-to-Book Ratio (P/B), Gross Profit and Gross Profit Growth were used in determining undervalued companies.

Justification

1. **P/B Ratio Less Than One:** The P/B ratio compares a company's market price to the value of its assets. Hence a ratio below 1 indicates that the company's stock price is lower than the value of its assets, that is, a company is worth more on paper (based on its assets) than what investors are paying for its stock, this could mean the stock is undervalued.
2. **Low P/E Ratio:** This shows how much investors are willing to pay for each dollar the company earns. A low P/E ratio suggests that the stock price is low compared to the company's earnings. This means that investors are getting a good deal if the company's earnings are strong and expected to grow, suggesting the stock is undervalued.
3. **Mid-Range Market Cap:** This measures the total value of a company's outstanding shares. Companies with a mid-range market cap often have established operations but still possess significant growth potential. They are less risky than small-cap companies but can offer substantial upside compared to large-cap stocks.

4. **Gross Profit (GP):** GP provides insights into the company's profitability. High GP indicates efficient operations and strong profit generation from core business activities, which is crucial for assessing financial health.
5. **Gross Profit Growth (GPG):** GPG measures how much the company's gross profit is increasing over time. It's calculated as:

$$\text{GPG} = \frac{\text{Gross Profit (current year)} - \text{Gross Profit (previous year)}}{\text{Gross Profit (previous year)}} * 100$$

Gross Profit (previous year)

COMPARATIVE ANALYSIS

Sector: Industrials

Industry: Rental & Leasing Services

Selected Company – Air Lease Corp

Peer 1- GATX Corp

Peer 2- Ryder System Inc.

Company	P/B ratio	P/E ratio	Market Cap.	GP (2023)	GP (2022)	GPG (%)
Selected Company	0.74	9.75	5.38 B	1,442.01	1,285.45	12.18
Peer 1	2.22	20.5	5.15B	647.30	527.60	22.69
Peer 2	1.88	17.00	5.76B	269.00	239.00	12.55

Table 1.0

Air Lease Corp is currently undervalued compared to GATX Corp and Ryder System Inc. Its low P/B ratio of 0.74 and P/E ratio of 9.75 suggest that its stock price does not fully reflect its true value. With a market cap of \$5.38B, Air Lease boasts a strong gross profit of \$1,285.45M and a gross profit rate of 12.18%, indicating solid financial health.

In comparison, GATX Corp's higher P/B ratio of 2.25 and P/E ratio of 20.5 may indicate that its stock is priced at a premium relative to its earnings and assets. It has a gross profit growth of 22.69%, reflecting good profitability but at a higher valuation.

Ryder System Inc. Despite having the highest market cap of \$5.76 billion, Ryder System Inc. shows the lowest gross profit growth at 12.55%, suggesting potential operational inefficiencies

or challenges. This lower growth rate, combined with its higher valuation metrics, raises concerns about its profitability relative to its peers.

Sector: Utilities

Industry: Utilities Diversified

Selected Company – Cia Energetica DE Minas Gerais

Peer 1- Allete, Inc.

Peer 2- Otter Tail Cooperation

Company	P/B ratio	P/E ratio	Market Cap.	GP (2023)	GP (2022)	GPG (%)
Selected Company	0.47	4.76	3.54B	1,523.33	1,304.87	16.74
Peer 1	1.30	15.30	3.68B	238.10	204.60	16.37
Peer 2	2.59	12.74	3.88B	394.53	408.18	-3.34

Table 1.1

Cia Energetica de Minas Gerais is notably undervalued relative to its peers. Its low P/B ratio of 0.47 and P/E ratio of 4.76 suggest the stock is priced below its intrinsic value. With a market cap of \$3.54B, the company achieved a gross profit of \$1,523.33M in 2023, a significant increase from \$1,304.87M in 2022, resulting in a robust growth rate of 16.74%.

Allete, Inc. demonstrates a higher valuation with a P/B ratio of 1.30 and a P/E ratio of 15.30. In terms of growth, Allete reported a gross profit of \$238.10M in 2023, an improvement from \$204.60M in 2022. This represents a growth rate of 15.37%. Although the growth rate is strong, it is relatively modest compared to Cia Energetica de Minas Gerais. Allete's higher valuation ratios imply that investors are willing to pay a premium for its stable profitability and growth, which might reflect confidence in its consistent performance and future prospects

Otter Tail Corporation has the highest P/B ratio of 2.59 and a P/E ratio of 12.74, indicating a more elevated valuation. It reported a gross profit of \$394.53M for 2023, a decrease from \$408.18M in 2022, resulting in a negative growth rate of -3.34, which highlights operational challenges despite its higher market cap.

Sector: Utilities

Industry: Utilities Diversified

Selected Company – NextEra Energies Partners

Peer 1- Atlantia Sustainable Infrastructure Plc.

Peer 2- Clearway Energy Inc.

Company	P/B ratio	P/E ratio	Market Cap.	GP (2023)	GP (2022)	GPG (%)
Selected Company	0.70	8.78	2.50B	57.00	46.00	23.91
Peer 1	1.86	48.53	2.56B	414.62	425.34	-2.52
Peer 2	1.32	35.28	2.72B	296.00	425.00	-30.35

Table 1.2

NextEra Energy Partners has a low P/B ratio of 0.70 and a P/E ratio of 8.78, indicating it may be undervalued. The company's gross profit increased to \$57 million in 2023 from \$46 million in 2022, showing a growth rate of 23.91%. This suggests solid financial improvement.

Atlantica Sustainable Infrastructure Plc has a higher P/B ratio of 1.86 and a P/E ratio of 48.53. Its gross profit slightly decreased from \$425 million in 2022 to \$414 million in 2023, resulting in a small negative growth rate of -2.52%.

Clearway Energy Inc. shows a P/B ratio of 1.32 and a P/E ratio of 35.28. It experienced a significant drop in gross profit from \$425 million in 2022 to \$296 million in 2023, leading to a decline of -30.35%. This indicates considerable challenges in profitability.

Sector: Consumer Cyclical

Industry: Apparel Manufacturing

Selected Company – G-II Apparel Group Ltd.

Peer 1- Figs Inc.

Peer 2- Goos Canada Goose Holding Inc.

Company	P/B ratio	P/E ratio	Market Cap.	GP (2024)	GP (2023)	GPG (%)
Selected Company	0.76	6.66	1.15B	1,214.32	1,073.38	13.13
Peer 1	2.59	48.77	1.01B	371.16	350.15	6.00
Peer 2	3.82	28.33	1.24B	596.57	545.73	9.32

Table 1.3

G-III Apparel Group Ltd. has the lowest P/B ratio of 0.76 and P/E ratio of 6.66, suggesting its stock is relatively undervalued. The company's gross profit for 2024 is \$1.21 billion, an increase from \$1.07 billion in 2023, resulting in a growth rate of 13.13%. This indicates a solid improvement in profitability.

Figs Inc. has a higher P/B ratio of 2.59 and a P/E ratio of 48.77, indicating its stock is priced higher relative to its earnings. Figs' gross profit grew to \$371.16 million in 2024 from \$350.15 million in 2023, achieving a growth rate of 6.00%. This shows positive growth but at a slower pace compared to G-III.

Canada Goose Holding Inc. has the highest P/B ratio of 3.82 and a P/E ratio of 28.33, reflecting a higher stock price relative to its earnings. The company's gross profit increased to \$596.57 million in 2024 from \$545.73 million in 2023, with a growth rate of 9.32%. This shows a steady increase in profitability but not as high as G-III's growth.

VALUATION MODEL

To estimate the company's value in 4 years, a valuation model was developed using historical gross profit (GP), gross profit growth (GPG), sector trends (represented by the S&P 500 index, GSPC), and market capitalization.

Justification on sector trends

The S&P 500 Index was chosen to track sector trends because, it reflects broader market conditions. It serves as a proxy for sector performance and overall economic health, influencing company valuations.

To generate the future gross profit, the gross profit growth rate is applied to the current gross profit. The term $GP \times (1 + GPG)^4$ represents the compound growth over 4 years. This approach assumes that the growth rate will be constant over the projection period and that the company's profitability will grow at this rate annually. This approach was also applied to the sector trend. Multiple linear regression is used to forecast future market capitalization.

Multiple Linear Regression Model

The model uses the following variables as predictors: Gross Profit (GP), Gross Profit Growth (GPG), S&P 500 Index (GSPC). The multiple linear regression formula is used to estimate the future market capitalization:

$$\text{Market Cap} = \beta_0 + \beta_1 \times \text{GP} + \beta_2 \times \text{GPG} + \beta_3 \times \text{GSPC}$$

where:

- β_0 is the intercept of the regression model.
- β_1 , β_2 , and β_3 are the coefficients for GP, GPG, and GSPC, respectively.

Historical data for GP, GPG, and GSPC over the past four years is used to estimate the coefficients (β_1 , β_2 , and β_3).

Projected Valuation for Air Lease Corp in next 4 years

Year	GP	GPG	GSPC	Market Capitalization
2020	803,015	0	2,711.02	5,050,000,000
2021	743,431	-59,584	3,756.07	5,040,000,000
2022	858,423	114,992	4,677.03	4,260,000,000
2023	961,295	102,872	3,839.50	4,650,000,000
Est.2024	1076495	115,200	3151.949047	37763111658
Est.2025	1205500	129,005	2587.519936	37565254064
Est.2026	1349966	144,465	2124.164864	37313945430
Est.2027	1511743	161,778	1743.784195	37008105922

The company's gross profit (GP) exhibits consistent growth, increasing from \$803,015 in 2020 to a projected \$1,511,743 in 2027. Despite this positive trend in GP, the market capitalization is forecasted to decline from \$5.05 billion in 2020 to approximately \$37 billion in 2027. Although gross profit growth (GPG) shows fluctuations, it trends upward after a decline in 2021. The S&P 500 Index (GSPC) initially rises but is projected to decrease significantly by 2027. This pattern indicates that, despite strong operational performance, the company may still be projected as undervalued in the next 4 years.

Projected Valuation for Cia Energetica DE Minas Gerais

Year	GP	GPG	GSPC	Market Cap.
2020	5,383,000	0	3,756.07	3,631,000,000
2021	6,723,000	1,340,000	4,766.18	3,980,000,000
2022	6,812,000	89,000	3,839.50	4,982,000,000
2023	8,384,000	1,572,000	4,769.83	5,218,000,000
Est.2024	10318769.23	1,934,769	5925.583599	43218424706
Est.2025	12700023.67	2,381,254	7361.38206	38336286016
Est.2026	15630798.36	2,930,775	9145.081649	32306567075
Est.2027	19237905.68	3,607,107	11360.98054	24859369535

Projections for 2024 to 2027 show a sharp rise in market cap relative to GP growth. This disparity suggests that although the company's financial performance is strong, the market capitalization may be disproportionately high, potentially indicating overvaluation in the later years.

Projected Valuation for NextEra Energies Partners

Year	GP	GPG	GSPC	Market Cap.
2020	554,000	0	3756.07	4,890,000,000
2021	348,000	-206,000	4766.18	7,070,000,000
2022	442,000	94,000	3839.5	6,060,000,000
2023	558,000	116,000	4769.83	2,840,000,000
Est 2024	704443.4	146,443	5925.584	9065221075
Est 2025	889320	184,877	7361.382	6695834741
Est 2026	1122716	233,396	9145.082	3749552158
Est 2027	1417366	294,649	11360.98	85858337.84

From 2020 to 2023, the company's gross profit (GP) grew slightly, while market capitalization decreased significantly, suggesting potential undervaluation. Projections for 2024 show GP rising to \$704,443 with a market cap of \$9.07 billion, indicating possible overvaluation. This trend of overvaluation continues into 2025. However, by 2026 and 2027, despite continued growth in GP, the market cap drops sharply to \$3.75 billion and then to just \$85.86 million, indicating that the company could be undervalued. Overall, the company appears overvalued in the early years of the projections and potentially undervalued in the later years.

Projected Valuation for G-III Apparel Inc.

Year	GP	GPG	GSPC	Market Cap.
2020	1,117.94	0	3,756.07	1,140,000,000
2021	744,442	743,324.06	4,766.18	1,340,000,000
2022	988,189	243,747	3,895.08	1,650,000,000
2023	1,101,137	112,948	4,754.63	1,550,000,000
Est.2024	1226994.727	125,858	5803.861907	16814170271
Est.2025	1367237.738	140,243	7084.633933	16491919166
Est.2026	1523510.241	156,273	8648.041385	16106766009
Est.2027	1697644.374	174,134	10556.45507	15645768336

Projections for 2024 show GP growing to approximately \$1.23 million, with market cap expected to rise significantly to \$16.81 billion. This suggests potential overvaluation as the market cap increases substantially compared to GP growth. The trend of high market cap relative to GP continues through 2025, 2026, and 2027. Despite steady GP growth, the market cap is projected to remain high, indicating that the company could be overvalued in the projected years

Additional Variable and it Expected Impact

NextEra Energies Partners

Technology Advancements in renewable energy significantly impact NexEra Energy valuation by enhancing efficiency and reducing costs. Improvements in solar panel and wind turbine technologies increase energy output and decrease maintenance costs. These advancements also align with regulatory incentives, providing financial benefits such as subsidies and tax breaks. Additionally, superior technology enables NexEra to gain a competitive edge, attract environmentally conscious investors a meet sustainable goal. Factoring these advancements into models leads high to projection of the company future market capitalization and overall financial health

Year	GP	GPG	GSPC	Market Cap.	Adjusted GP Impact with Tech
2020	554,000	0	3756.07	4,890,000,000	
2021	348,000	-206,000	4766.18	7,070,000,000	
2022	442,000	94,000	3839.5	6,060,000,000	
2023	558,000	116,000	4769.83	2,840,000,000	
Est 2024	704443.4	146,443	5925.584	9065221075	13552969.99
Est 2025	889320	184,877	7361.382	6695834741	16319021.95
Est 2026	1122716	233,396	9145.082	3749552158	20601842.2
Est 2027	1417366	294,649	11360.98	85858337.84	26008660.51

Conclusion

The analysis identifies Air Lease Corp and Cia Energetica de Minas Gerais, as potential undervalued companies, based on their low P/B ratios and strong gross profit growth relative to peers. Despite solid operational performance, market capitalization projections suggest these companies may be undervalued or overvalued depending on future market conditions and trends.

References

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