



**New Constructs®**  
Diligence | Independence | Performance

# Technology:

## To Save Time, Reduce Risk & Make Smarter Decisions

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The recipient of this report is directed to read these disclosures.

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New Constructs, LLC

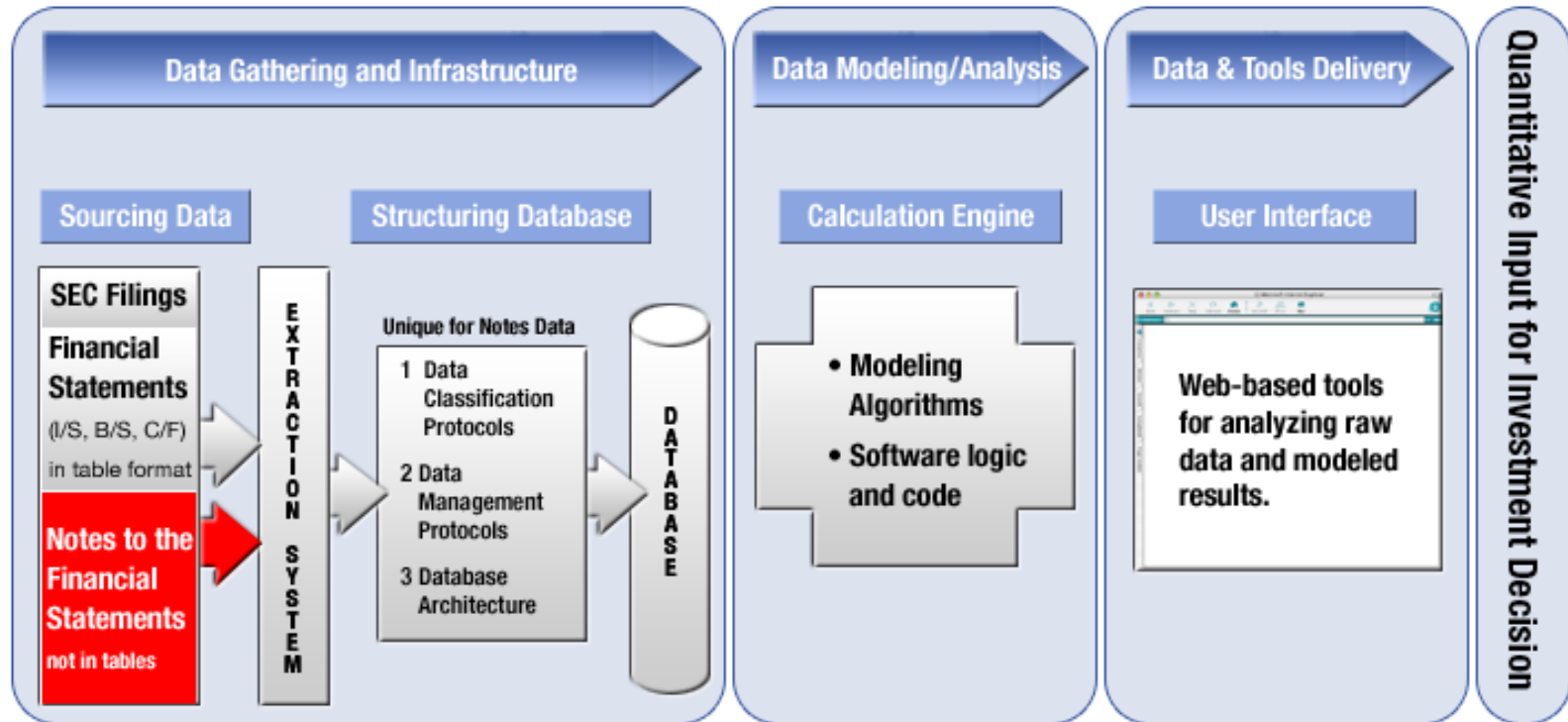
# Current Clients Include

- Top wealth management firms
- Top advisors
- Top accounting & consulting firms



# Proprietary Research Platform

Only Firm That Gathers Data and Produces Research



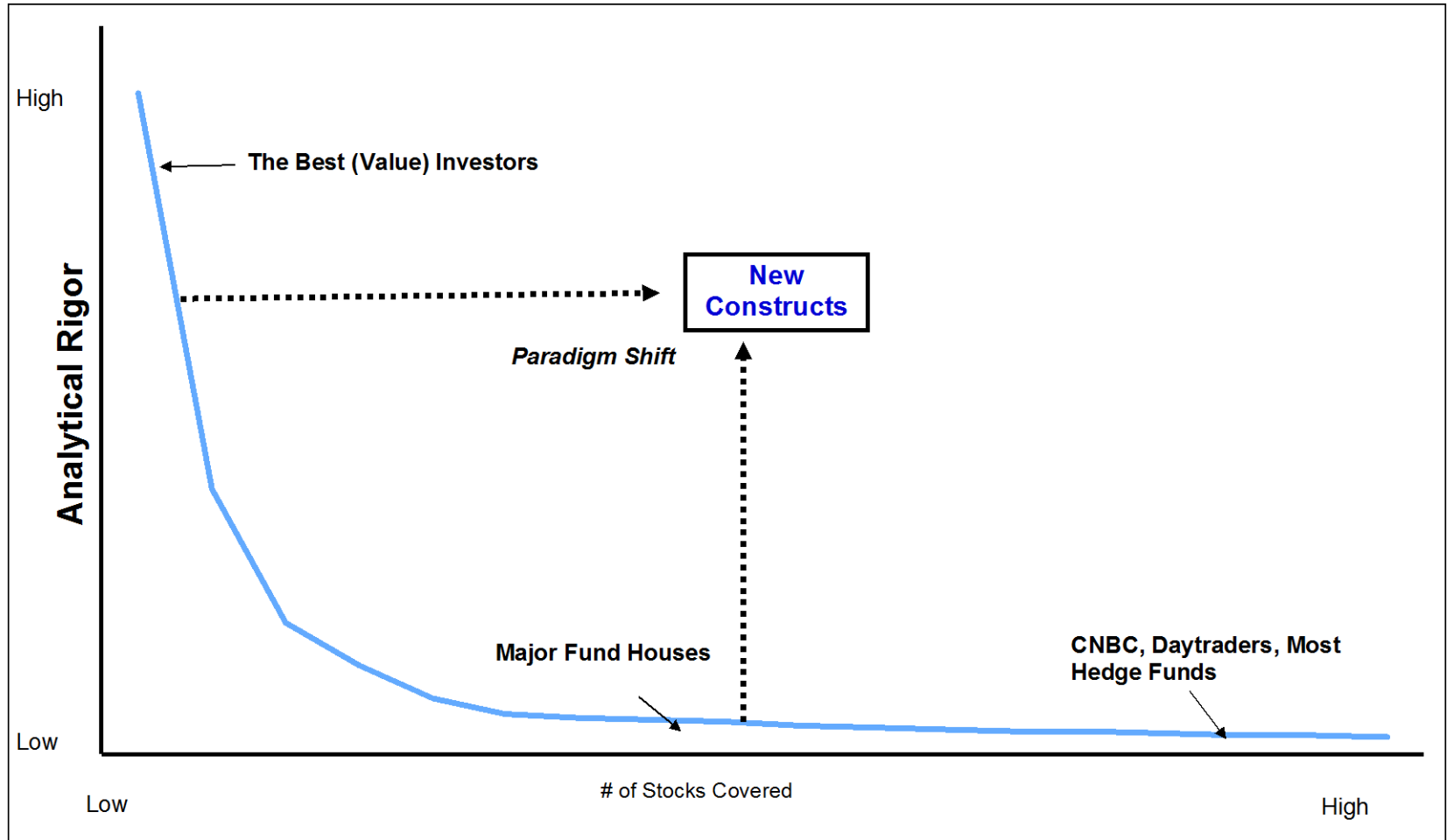
Source: Novo Capital Management, LLC

Gathering and analyzing data from the *Notes to the Financial Statements* is key to better analysis and understanding of:

1. Profitability and
2. Valuation.

# Deep Research on 100,000+ 10-Ks & Qs

## Best Insights on 3000+ U.S. Stocks



# Part I

## Understand the Problems & Risks

## Questions:

What is Wall Street's big secret?



Stock Research/Recommendations Are Biased & Incomplete

## Questions:

Where do you find these guys?





## Questions:

Who is there to protect you?





## Questions:

- What is “Reg FD”?
- What was the purpose of the Global Research Settlement?
- What is a 10-k?
- What are “footnotes”?
- What is a gold rush?

## Question:

How has the Market Changed over the years?

### Shorter Holding Periods for Stocks

- Until mid-1960's average holding period was seven years
- Today, average holding period is less than one year and annual portfolio turnover is more than 100%<sup>1</sup>

### Major Reactions to Quarterly Earnings

- Stock prices make large moves in response to earnings surprises
- Suggests that long-term cash flows are less important

### Amateur Individual Investors - Growth Market

- Schwab, TD Waterhouse, Scottrade
- Day trading

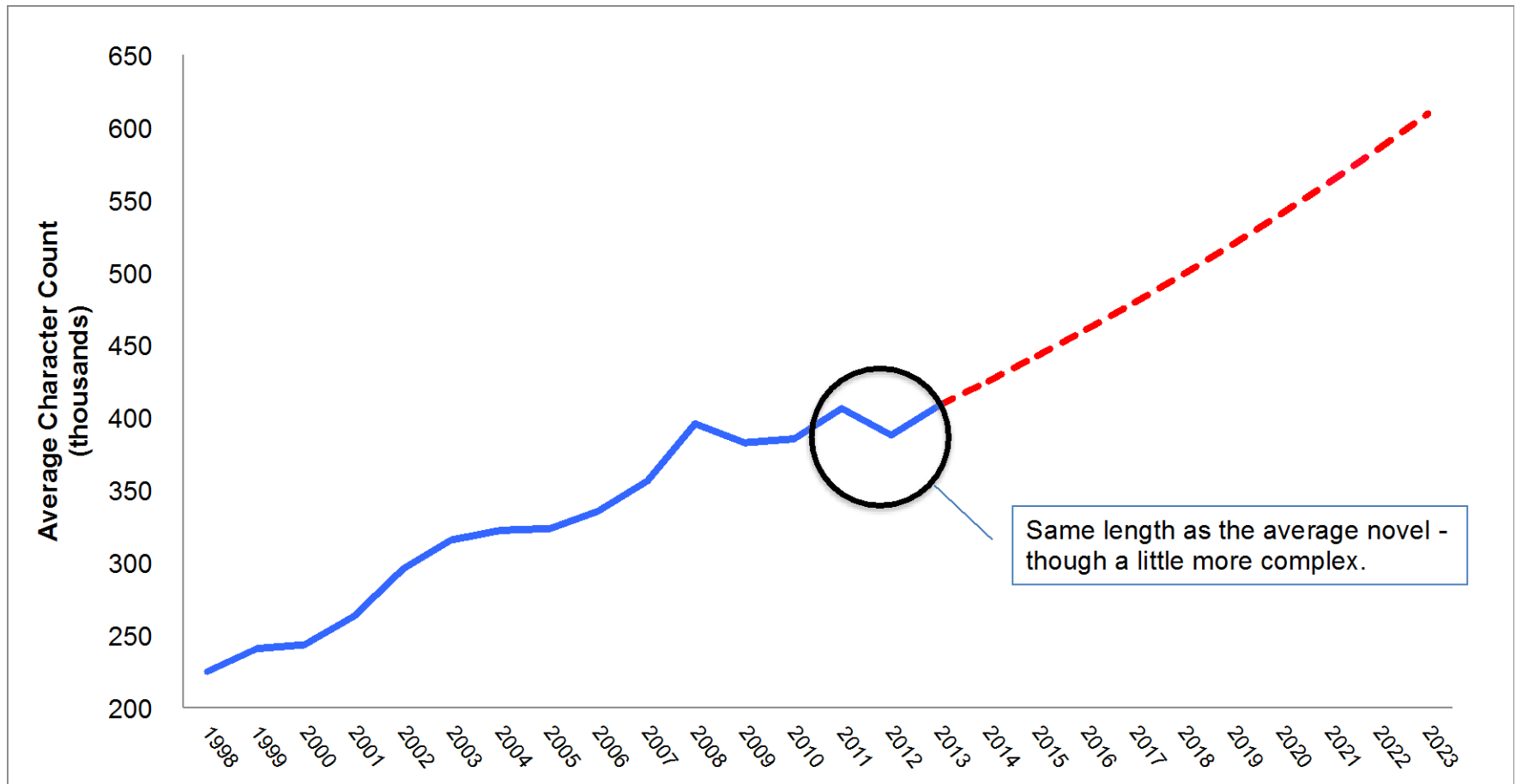
### Media - Growth Market

- TV: Mad Money, CNBC Squawk Box, and Squawk on the Street
- Print: Wall Street Journal, Investors Business Daily, local newspapers
- Web: Motley Fool, TheStreet.Com, CBS MarketWatch

<sup>1</sup>Rappaport, Alfred. "The Economics of Short-Term Performance Obsession." *Financial Analysts Journal*, vol. 61, no. 3 (May/June): 65-79.

# Average Length of 10-Ks Is Quite Long

Keeping Up With Disclosures Is Nearly Impossible



# Disclosure Trends Are Not Your Friend

*More Data, More Noise*

- Filings have grown to **200+ pages**  
*(That's longer than the average novel.)*
- Increasingly complex and time-consuming work
- Accounting rules are constantly changing



# People Forgot What Investing Was

## Speculator

“If you are a speculator, your decision to buy or sell is based on what you believe about the near-term direction of price.”  
- Ben Graham

“...speculation is the activity of forecasting the psychology of the market.”  
- John Maynard Keynes

Vs.

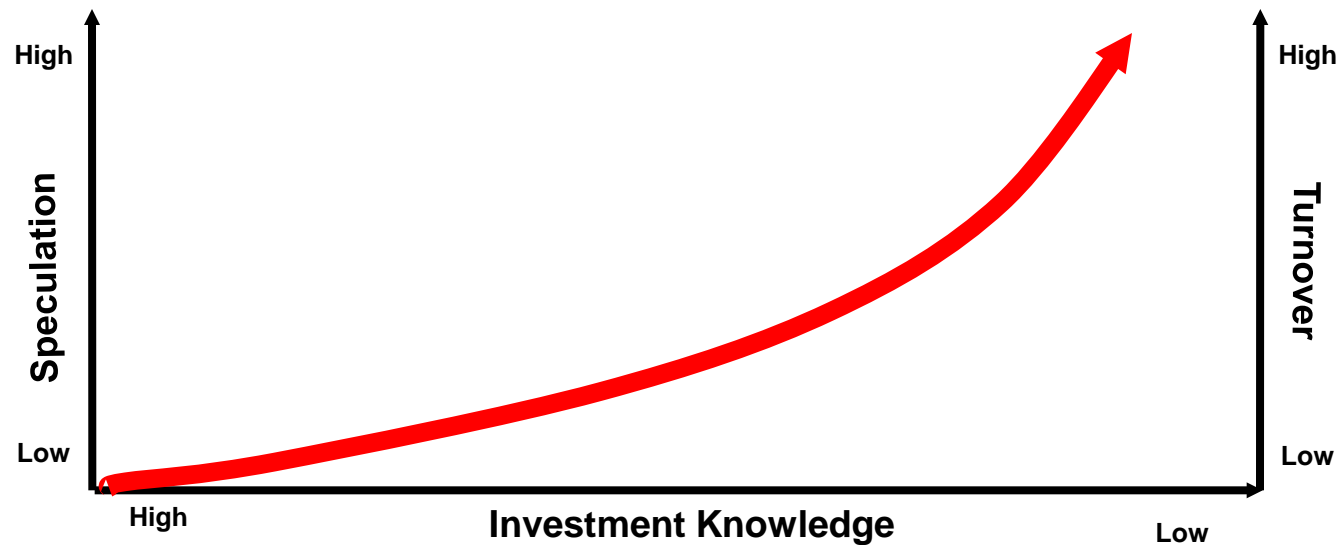
## Investor

“If you are an investor, your decision to buy and sell is based on the underlying economics of the stock you own.”  
- Ben Graham

“Investing is an activity of forecasting the yield on assets over the life of the asset...”  
- John Maynard Keynes

# Noise Trumps Knowledge & Skews Valuations

## People Who Know Less Tend to Trade More



### Percentage Breakdown of Institutional Investor Categories

Quasi-Indexers	61%
Transients	31%
<u>Dedicated</u>	<u>8%</u>
Total	100%

### Institutional Investor Categories Definitions

1. Quasi-indexers - low turnover and small stakes
2. Transients - high turnover and small stakes
3. Dedicated - low turnover and large stakes

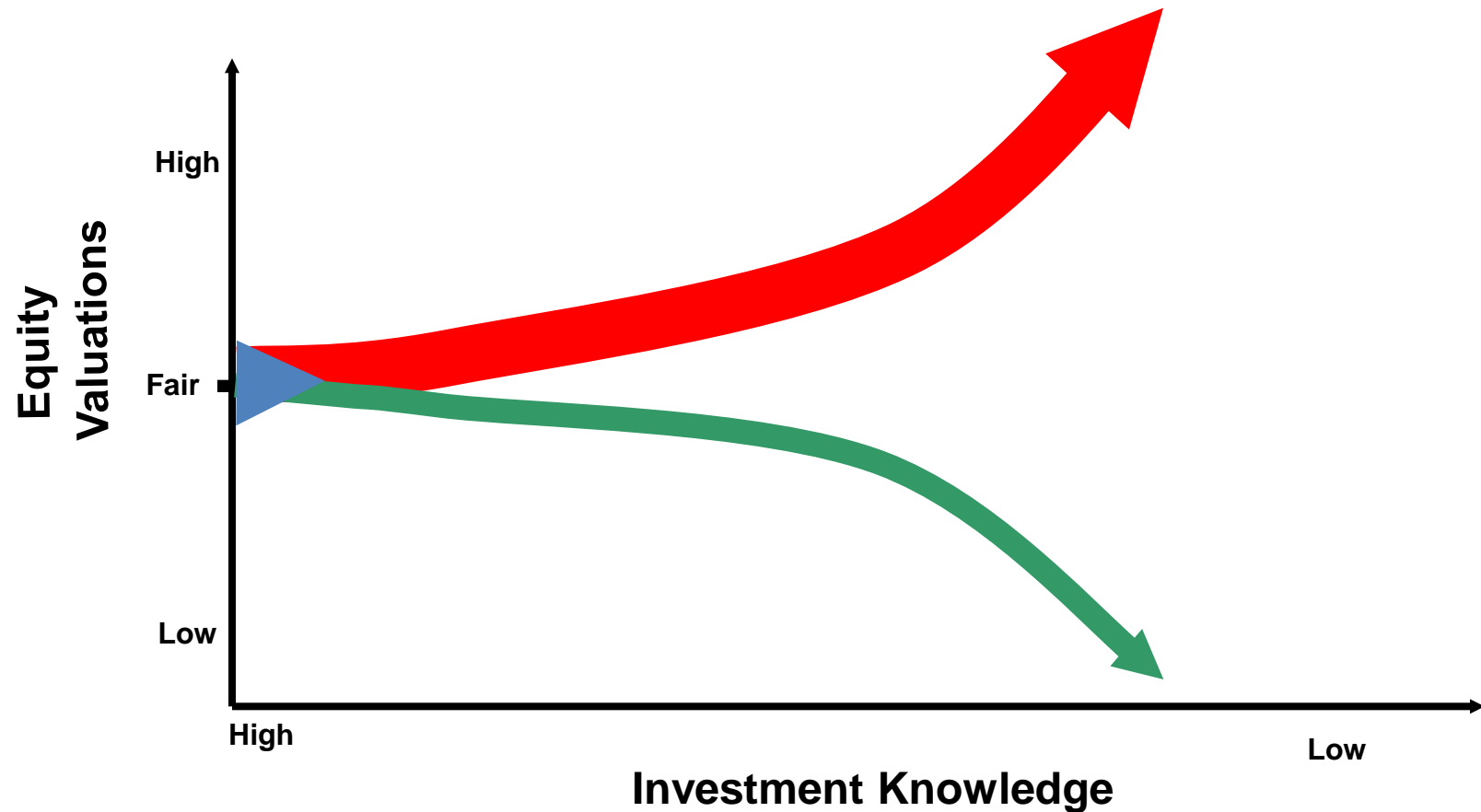
Source: Brian Bushee, "Identifying and Attracting the 'Right' Investors: Evidence on the Behavior of Institutional Investors," Journal of Applied Corporate Finance, Vol. 16, 4, Fall 2004, 28-35



# Speculators Skew Equity Valuations

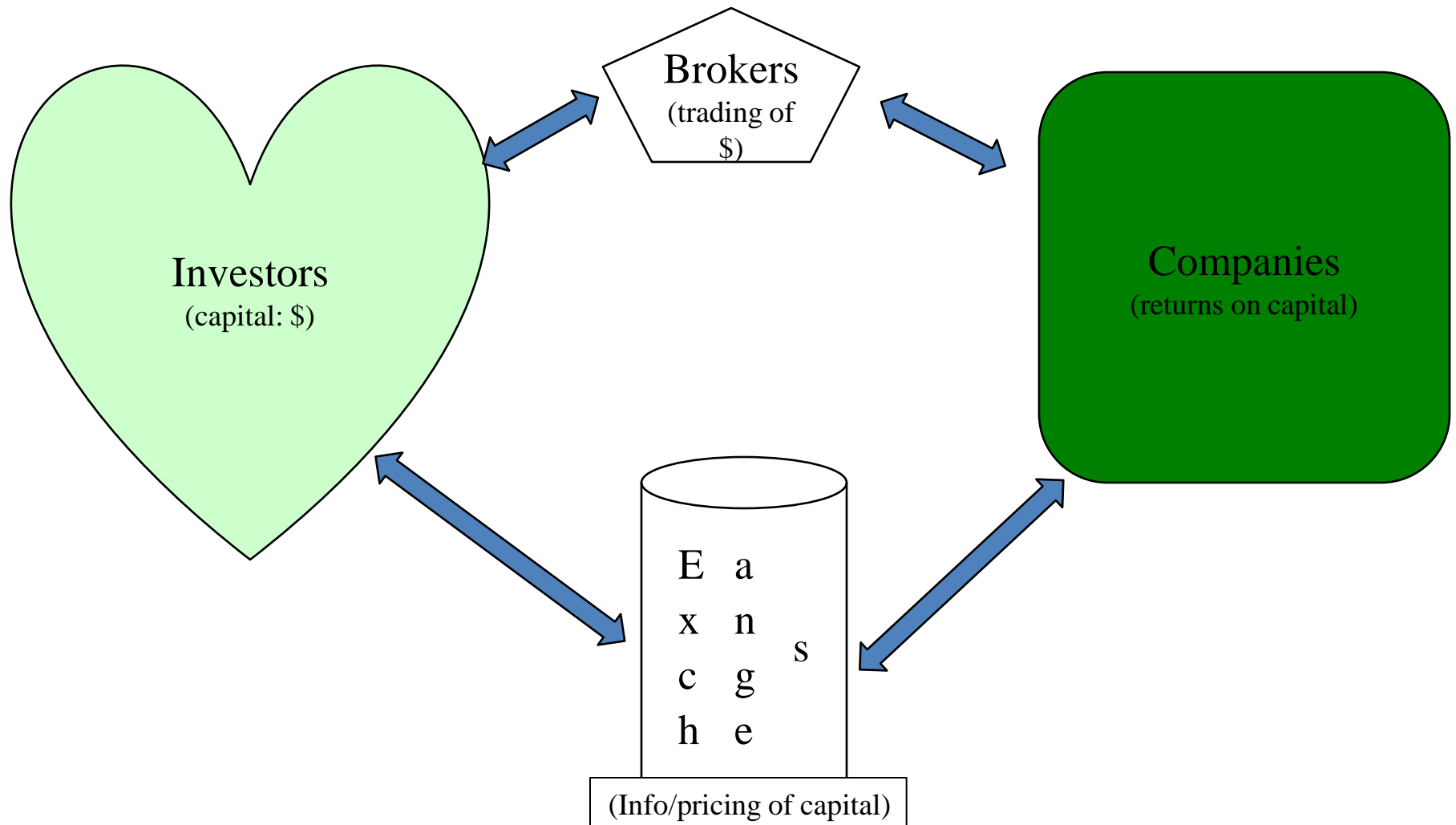
## Noise, Turnover and Volatility Create Aberrations

**Unrealistic Expectations Become A Self-Fulfilling Prophecy**



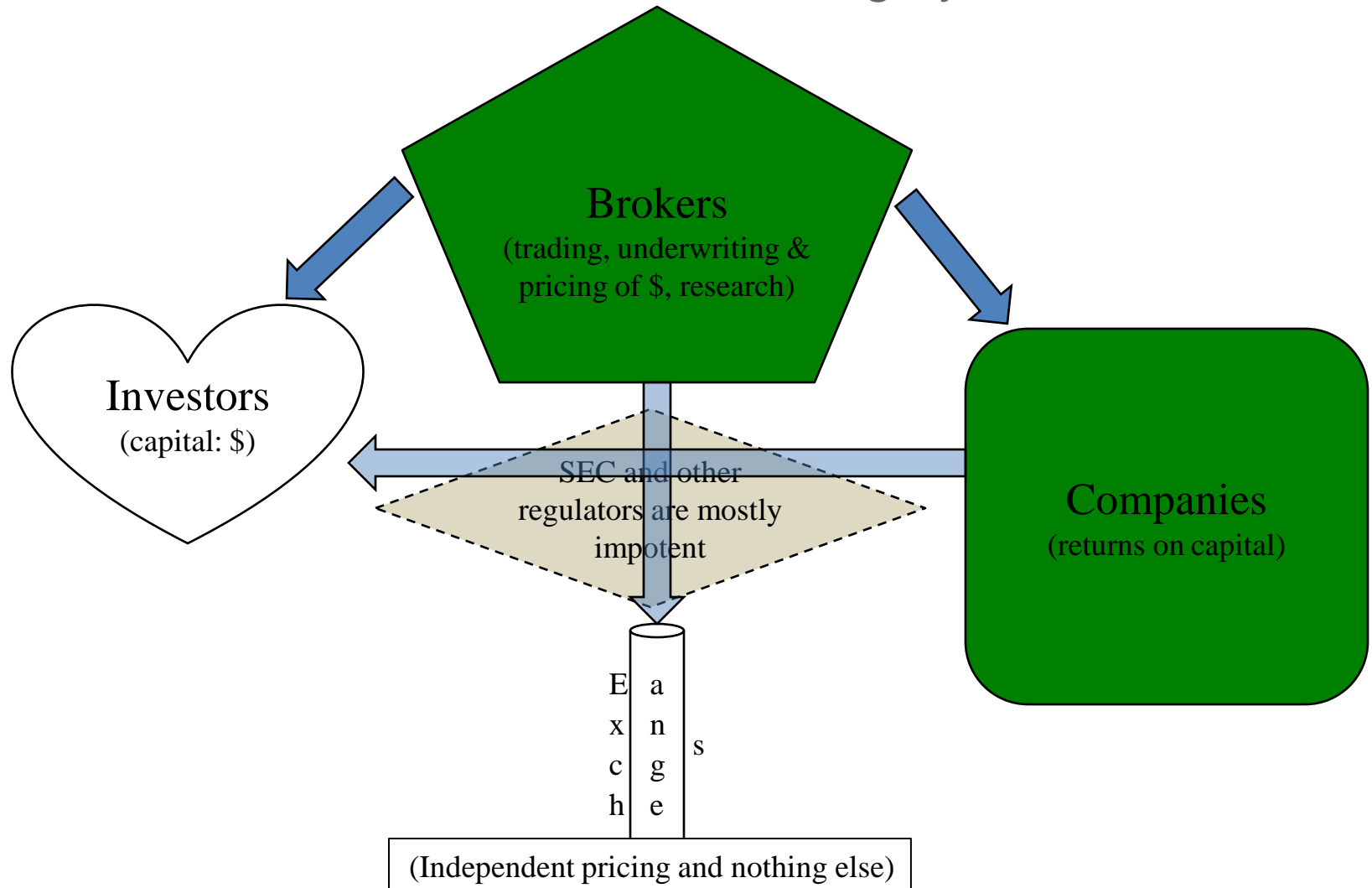
# Capital Markets Eco-System In Theory

Integrity of Information Is Key



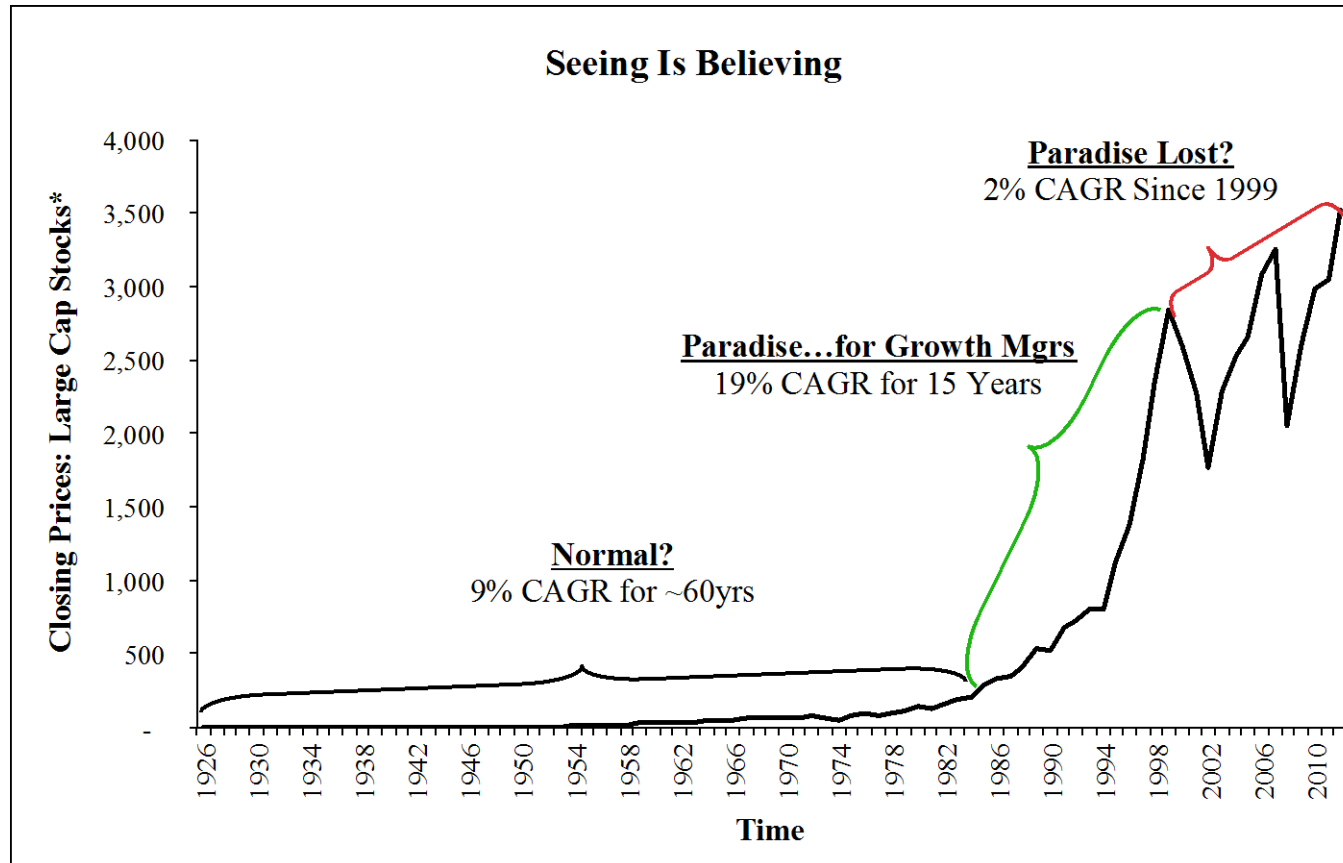
# Capital Markets Eco-System In Reality

Conflicts of Interest Undermine Integrity of Info Flow



# Extraordinary Market Growth

## Impact On Investor Expectations



Source: Novo Capital Management, LLC and Ibbotson

Ibbotson, 2008 Ibbotson Stocks, Bonds, Bills and Inflation Valuation Yearbook, (Chicago: Morning Star, 2008), 228-229

•Large Cap Stocks” as defined by Ibbotson are the best comparison for the S&P 500, which did not exist as it does today in 1926.

# Part III

## Keys to Success

# No Substitute For Rigorous Analysis

## Only 3 Ways to Beat the Market

Better Data - difficult and expensive to obtain

- Gathering and analyzing data from the Notes to the Financial Statements provides a competitive advantage.

Better Analysis - not just your neighbor, one must out-think the entire market

- Better data means better models.
- Better models provide better analysis.

Better Discipline - stick to your guns, don't follow the herd.

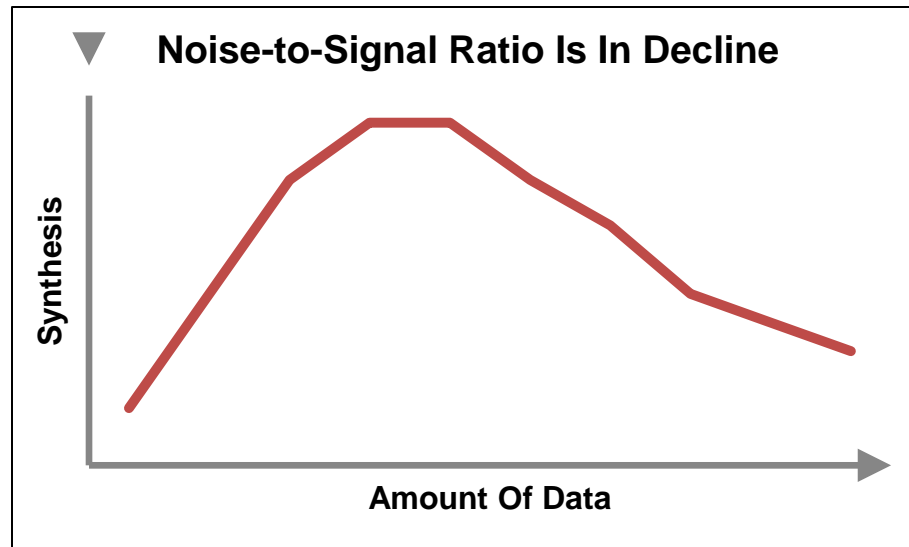
- Long and short strategy is built on specific, quantifiable thresholds derived from a model we can trust.
- Our models do all the number crunching to supply our human capital with superior information and decision-making capabilities.



# Status of Investing Business in Digital Age

## Stage 1: Digitization and explosion of data

- Online trading, technical tools and research
- Commodity analyses based on commodity data
- *Not much left here*



## Stage 2: Synthesis – deriving meaning from data

- Deeper insights into fundamentals
- Proprietary analyses based on proprietary, unique data
- *Just beginning*

# Stages of Evolution in the Digital Age

## Just Beginning Stage 2

Stage 1 = digitization of data and processes, explosion in amount of data

Stage 2 = synthesis of data, making it useful

- *Just beginning*

Stage 3 = repeat Stages 1 & 2 but with bad data/info purposely introduced into the system...and the process continues

# Investment Decision Process

Respect the Task: Propaganda Should Not Rule the Day

## ***Quantitative Work***

### **Gather Data & Build Models**

SEC Filings	Data entry
Database vendors	Excel modeling
Sellside Analyst	

## ***Qualitative Work***

### **Strategic Analysis**

Barriers	Strategic Choice
Rivalry	*Differentiation
Substitutes	*Cost
Customer Power	*Focus
Supplier Power	

## Why Diligence Is Needed

Core Problem: GAAP is exploitable.

Only Solution: Read the Footnotes and MD&A.

### Traditional P&L

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Revenues

- operating expenses

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= pretax earnings

- taxes

---

= Reported Profit

### Economic P&L

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Revenues

- operating expenses

- **Hidden Incomes/Charges**

---

= pretax earnings

- taxes

---

= Profit

- **capital charge/hidden liabilities and assets**

---

= Economic Profit

# What Is the Diligence Needed

## Scouring the Footnotes and MD&A

- Hidden Expenses/Income
- Unrecorded Goodwill
- Impairments
- Unconsolidated Subsidiaries
- Minority Interests
- Unrealized Gains/Losses
- Changes in Accounting Rules
- Derivatives Exposure
- Customer Concentration
- FASB 159
- Employee Stock Options
- Option Valuation Assumptions
- Operating Leases
- Loan Loss/LIFO Reserves
- Pension Assumptions
- Excess Cash
- Pension Over/Under Funding
- Auditor's Opinions
- Carrying Value vs Fair Value
- Mid-year acquisitions

*Depth and Breadth Is Critical*

## Discover the Economics

### Measuring Key Results

- **NOPAT** ➡ core operating earnings after-tax
- **Invested Capital** ➡ all cash invested in the business
- **WACC** ➡ rent management must pay for use of capital

Return on Invested Capital = NOPAT/Invested Capital

Economic Profit = (ROIC – WACC) \* Invested Capital

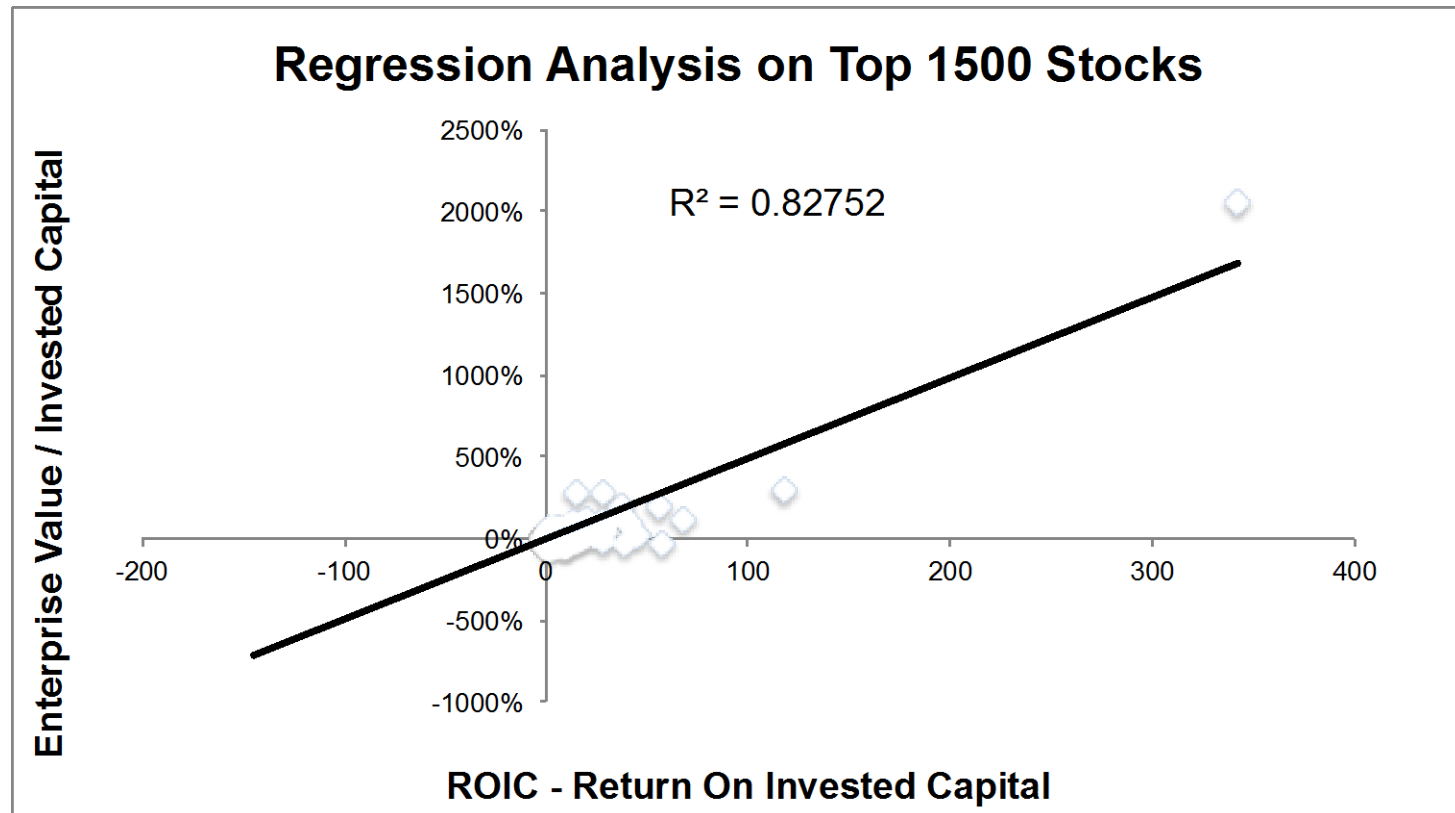
Free Cash Flow = NOPAT – change in Invested Capital

**Economic Profit Margin = ROIC - WACC**



# Why Do Cash Economics Matter

Market Assigns Value to Where It Gets the Most in Return

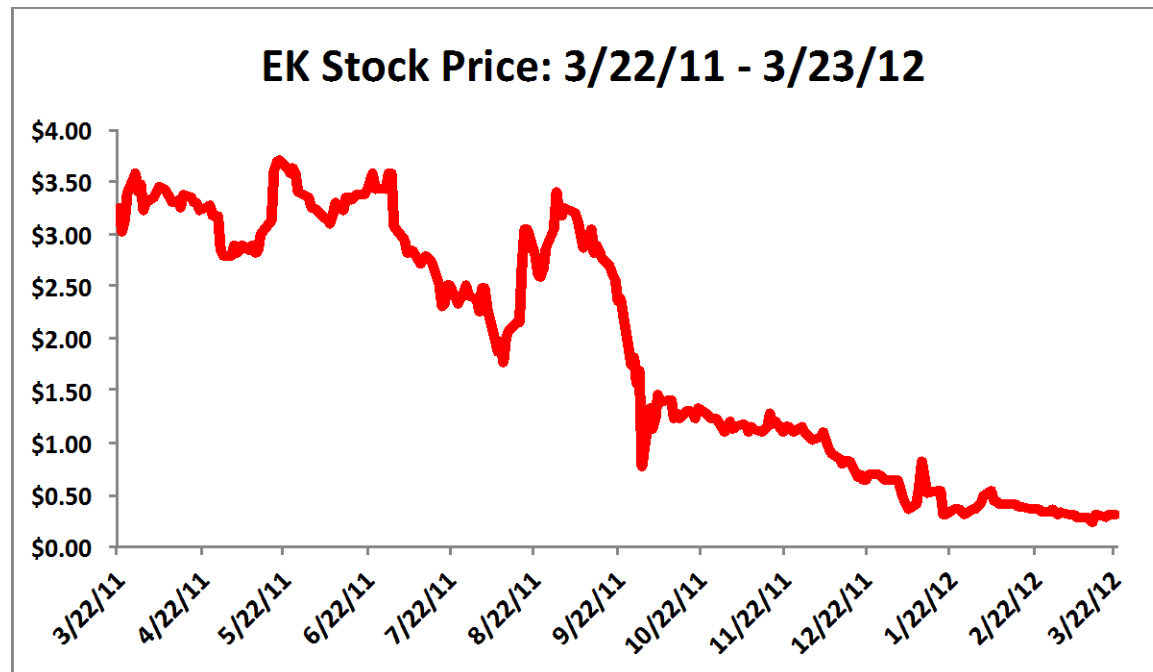


## Diligence Pays

Sell Call: Eastman Kodak (EKDKQ.PK) on [3/21/2011](#)

### 2010 10-K Revealed Funny Pension Attg

1. Underfunded by \$2.6bn or 3x the market cap at the time
2. 2.2% of revs from pension, abnormally high return on plan asset assumption 8.7%
3. Valuation implied 10% CAGR in NOPAT for 11 years
4. Down 90% while S&P500 was down ~3%, no longer under coverage



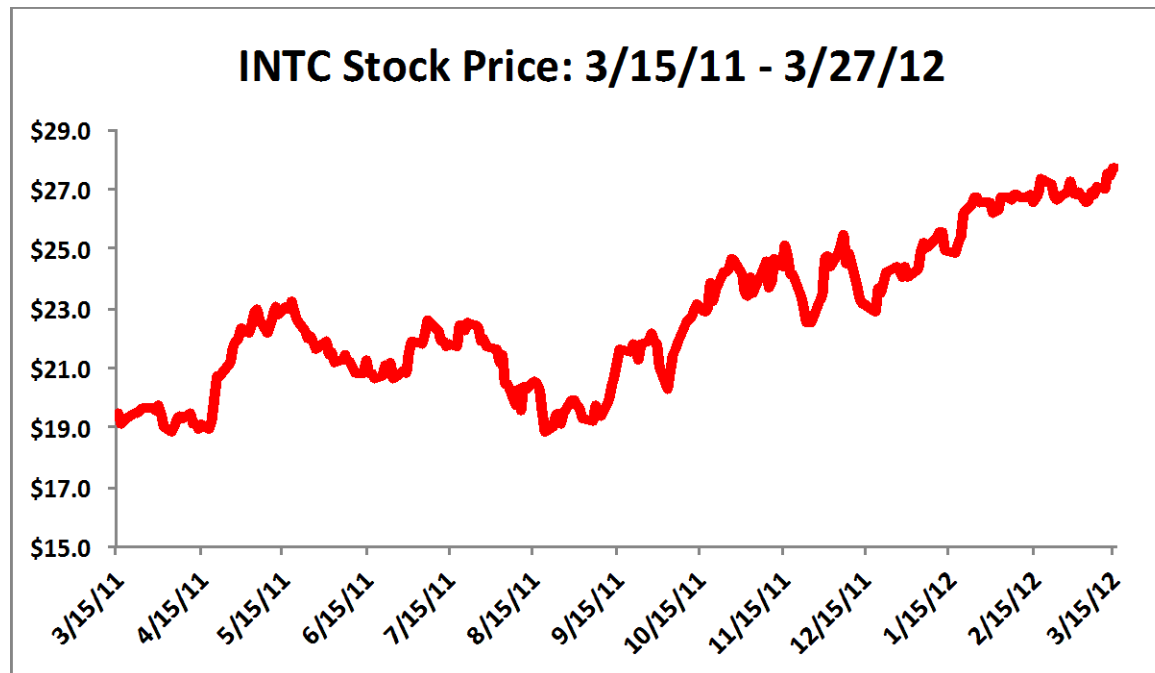
\*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

# Diligence Pays

## Buy Call: Intel (INTC) on 3/15/2011

### Excess Cash Drives Higher ROIC

1. \$26 billion in excess cash in 2010
2. ROIC more than doubled to 31%
3. Valuation implied permanent 30% decline in profit (NOPAT)
4. Up 45% while S&P500 was up ~5%, no longer recommending



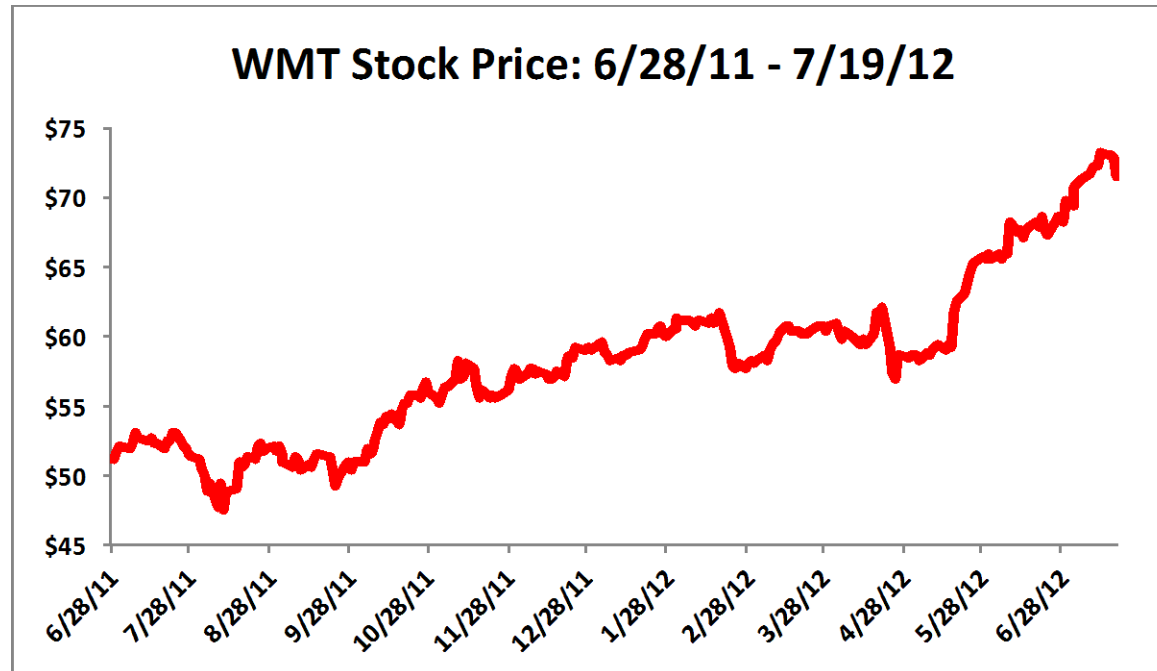
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# Diligence Pays

## Buy Call: Wal-Mart (WMT) on 6/28/2011

### Focus on ROIC and valuation

1. Superior ROIC and consistency of economic earnings
2. Valuation implied permanent 35% decline in profit (NOPAT)
3. Up 40% while S&P500 was up ~9%, closed position on 7/19/12



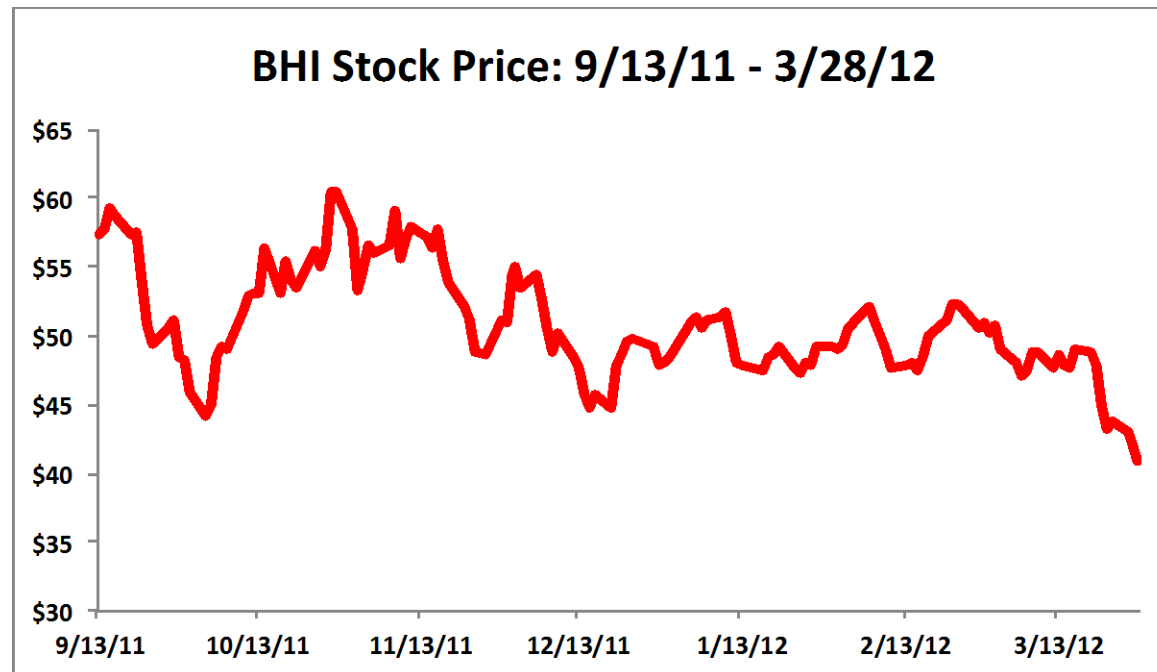
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## Diligence Pays

### Sell Call: Baker Hughes (BHI) on 9/13/2011

#### 2010 10-K – Acquisition Accounting Overstated EPS and Margins

1. Economics of BJ Services deal were bad: accounting creates “[hi/lo fallacy](#)”
2. [Economic earnings](#) diverged from reported earnings. Stock follows economics.
3. Valuation implied 20% CAGR in NOPAT for 12 years
4. Down 30% while S&P500 was up ~20%, Neutral rated as of 3/21/12



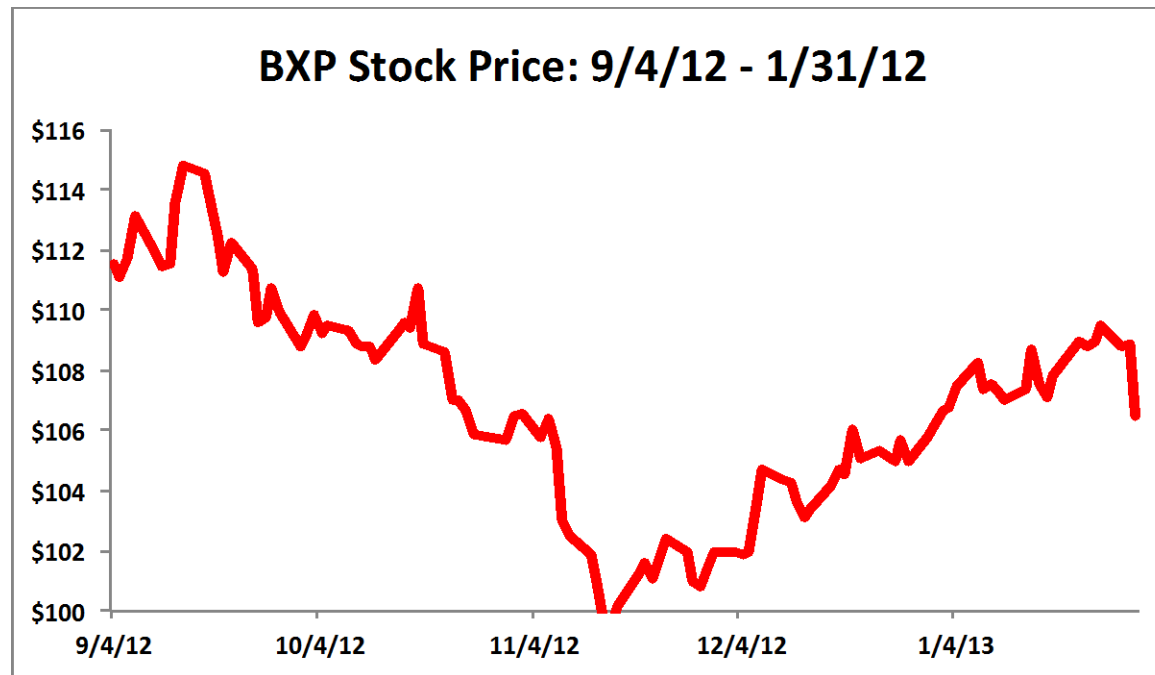
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## Diligence Pays

### Sell Call: Boston Properties (BXP) on 9/4/12

#### Overstated Profits Due To Bloated Balance Sheet

1. Misleading earnings as balance sheet is growing faster than cash flow
2. Dividend yield does not compensate for downside capital risk
3. Valuation implies 15% CAGR in NOPAT for 15 years
4. Down 5% while S&P500 is up about 7%, position remains



\*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

# Part IV

## More About New Constructs

## Quick Overview:

### Independent Proprietary Research & Diligence

- Founded July 2002
- Top-rated stock-picking by [Barron's](#)
- Deep, financial fundamental focus
- Patented research platform covers 3000 stocks & 7400+ funds
- Untapped source of alpha
- Footnotes expertise is a competitive advantage
- Integrated ratings for stocks, ETFs and mutual funds



# Value Proposition To Clients

How I Help You Make Better Investments & Raise Assets

## 1. Unrivalled Level of Diligence

- Heavy lifting and analysis of Footnotes
- Avg 10-K is 300 pages

## 2. Superior Insight

- [Diligence pays](#)

## 3. Competitive Differentiation

- Leading, not following
- Competitors cannot match your diligence or insights
- Early mover advantage

# Product Details and Samples

# Stock Research

## Real Diligence and Hard Work

- Top-rated stock-picking by [Barron's](#)
- 3000+ US stocks – reports and models updated daily
- Focus on true economic earnings via footnotes study
- Sophisticated valuation analysis
- 100% transparent adjustments
- Customizable models
- Custom feeds
- Screener
- Monthly newsletter on [Most Attractive](#) and [Most Dangerous](#) stocks

Click for [sample report](#)

# ETF Research

## Real Diligence and Hard Work

- 475+ US Equity ETFs
- Reports updated daily
- Truly predictive rating
- Based on bottoms-up research of holdings
- Leverages research on individual stocks
- Transparent [methodology](#)
- [ETF screener](#)

Click for [sample report](#)

# Mutual Fund Research

## Real Diligence and Hard Work

- 7400+ US Equity ETFs
- Reports updated daily
- Truly predictive rating
- Based on bottoms-up research of holdings
- Leverages research on individual stocks
- [Total Annual Costs](#): apples-to-apples analysis of all-in costs
- Transparent [methodology](#)
- [Fund screener](#)

Click for [sample report](#)

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