



New Constructs®

Diligence | Independence | Performance

ROIC: The Paradigm For Linking Corporate Performance To Valuation

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**Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.**

Agenda

- 1) Core principles behind ROIC**
- 2) Why more investors don't use ROIC**
- 3) How to calculate ROIC**
- 4) How to scale ROIC**
- 5) Additional resources**
 - Case study: Oracle (ORCL)
 - Most Attractive stocks
 - Most Dangerous stocks
 - Fund Ratings
 - More free research

New Constructs Beliefs

The purpose of the capital markets is to allocate capital to its most efficient use.

- Key driver to improvements in standards of living around the world.

New Constructs Beliefs

Investing principles

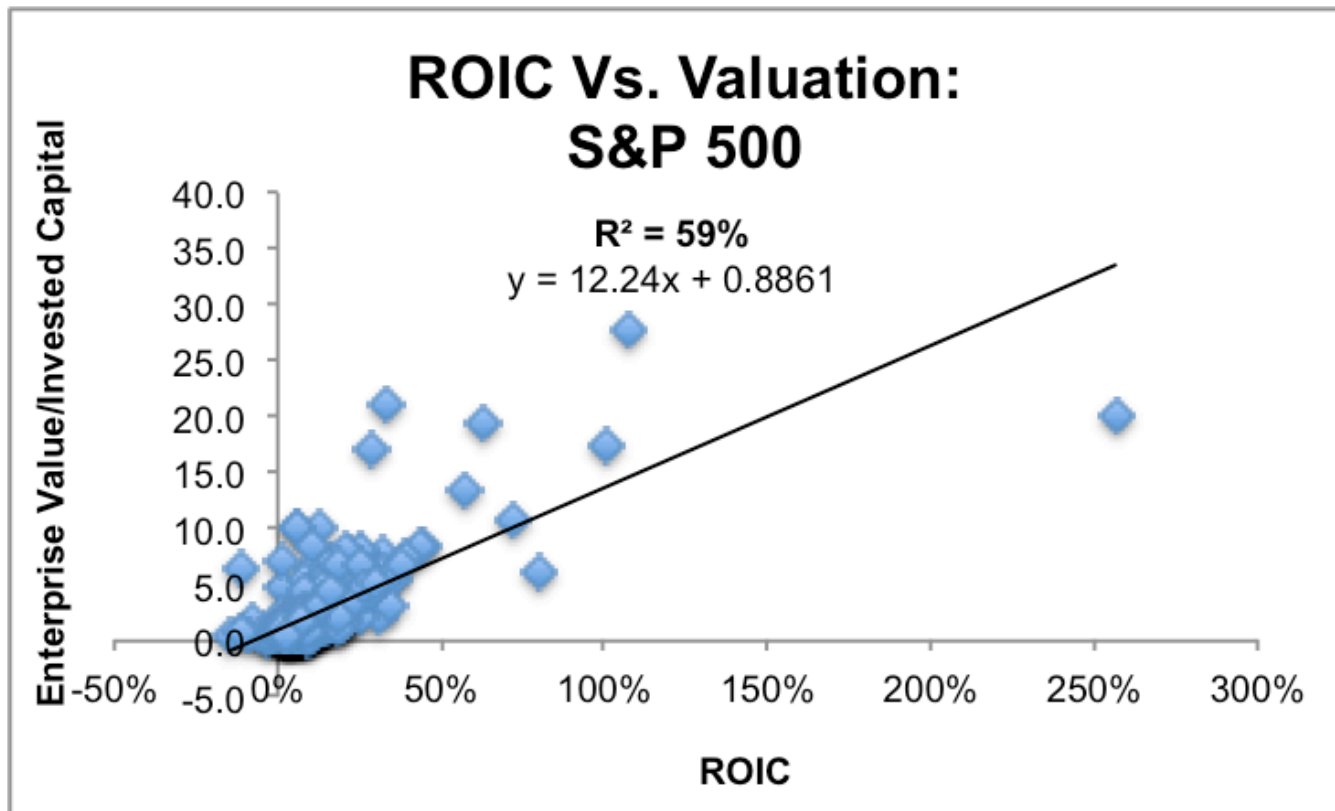
- (a) real cash flows matter and
- (b) superior profitability is ultimately rewarded by the market.

Standing Up For Our Beliefs

- Find best measure of cash flow profitability
- The relationship between return on invested capital (ROIC) and stock valuation is intuitive.
- Over the long term, the market assigns the most value per dollar invested to the companies that produce the most cash per capital invested.

Bedrock Observation

- Statistical analysis shows that the biggest driver of stock valuation is, by far, ROIC.



Why Don't More People Focus on ROIC?

If ROIC is So Great, Then Why Doesn't Everyone Use It?

Answers:

1. Too many people are focused on other things
2. ROIC is too much work

Few Investors, Mostly Speculators

Investor Population Has Changed

Percentage Breakdown of Institutional Investor Categories

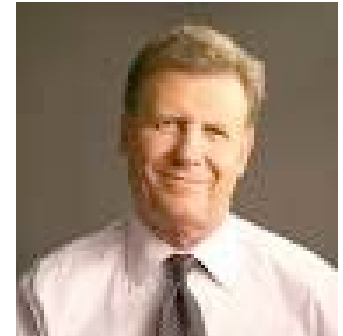
Quasi-Indexers	61%
Transients	31%
<u>Dedicated</u>	<u>8%</u>
Total	100%

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

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

Who are these people: Entertainment or serious business?



Companies Are Not On Your Side

From Enron's in-house risk management manual:

“Reported earnings follow the rules and principles of accounting.

The results do not always create measures consistent with the underlying economics.

However, corporate management's performance is generally measured by accounting income, not underlying economics.

Therefore, risk management strategies are directed at accounting, rather than economic, performance.”

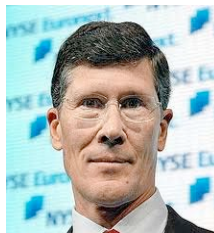
- The Smartest Guys In The Room by Bethany McLean and Peter Elkind page 132



Disclosure Trends Are Not Your Friend

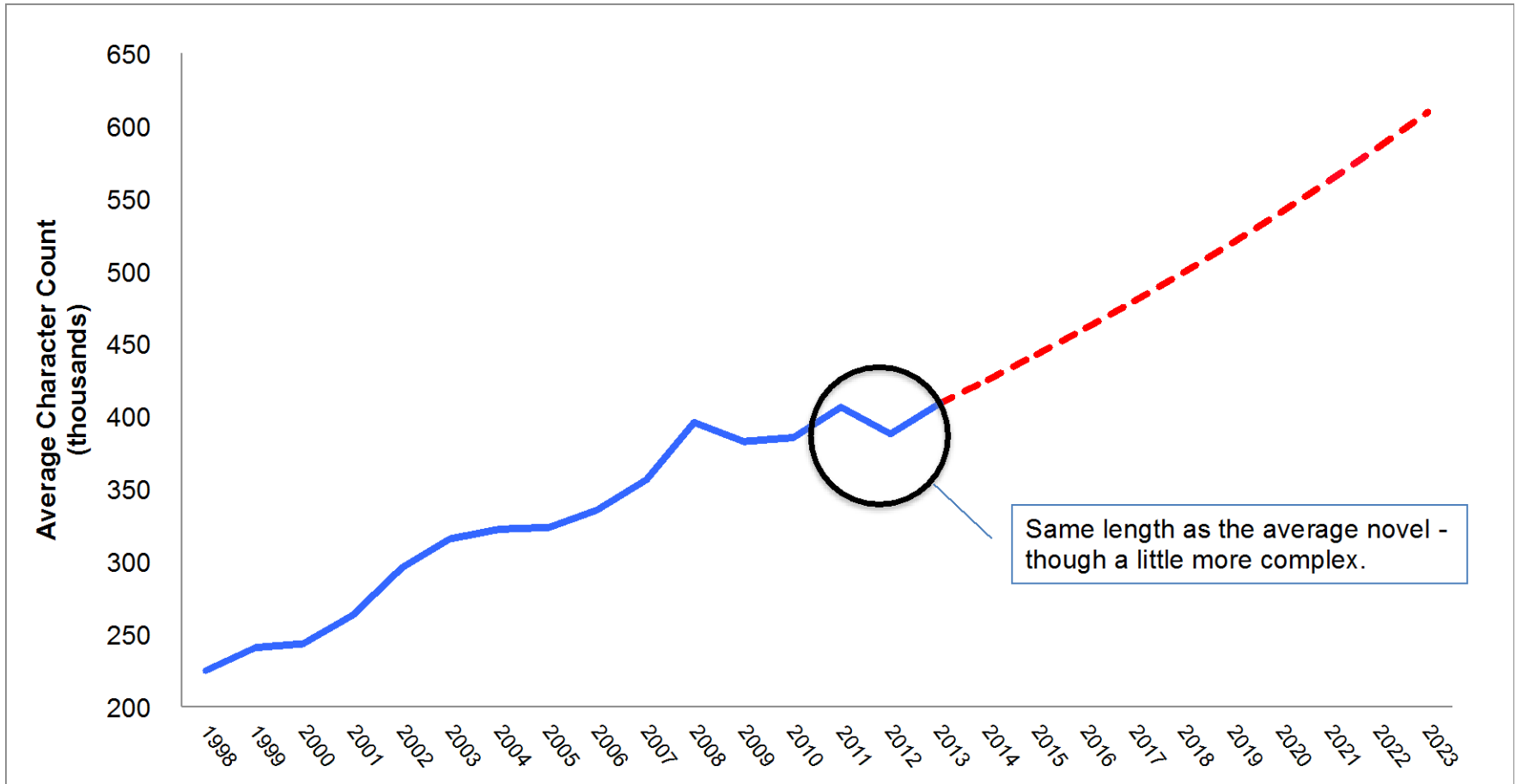
More Data, More Noise

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



Analytical Rigor Hard To Scale

Keeping Up With Disclosures Is Nearly Impossible



How To Calculate ROIC

ROIC: Easy Concept, Hard to Execute

Calculating ROIC is hard. The formula for it seems simple, it's just:

NOPAT/Invested Capital

or

Net Operating Profit After Tax (NOPAT) divided by Invested Capital.

DuPont model/Drivers of ROIC:

NOPAT Margins * Invested Capital Turns

NOPAT/Revenue * Revenue/Invested Capital

Getting ROIC Right Is Not Easy

Scouring fine print for these important adjustments

- 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

[Link](#) to white papers on each of these adjustments.

Protection: Why Diligence Is Needed

Core Problem: GAAP is exploitable.

Only Solution: Read the Footnotes and MD&A.

Traditional P&L

Revenues

- operating expenses

= pretax earnings

- taxes

= Reported Profit

Economic P&L (ROIC-WACC)

Revenues

- operating expenses

- **Hidden Incomes/Charges**

= pretax earnings

- taxes

= Profit

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

= Economic Profit (ROIC-WACC)

ROIC: Easy Concept, Hard to Execute

1. Do it on your own
 - Most investors simply don't have the time & expertise to dig through long filings and model these adjustments.
2. Get it from someone else
 - Who?
 - No alternative to relying on inferior metrics.
 - Do you hear Cramer talk about ROIC.

Understand the conflicts in traditional research:
["Why Investors Need Independent Research"](#).

Click here for white papers on
[suboptimal metrics](#).

Evidence: EPS & Rating Manipulation

MarketWatch.com and Financial Times headlines

[MarketWatch.com 8/18/2015](#): Survey of 500+ CFOs

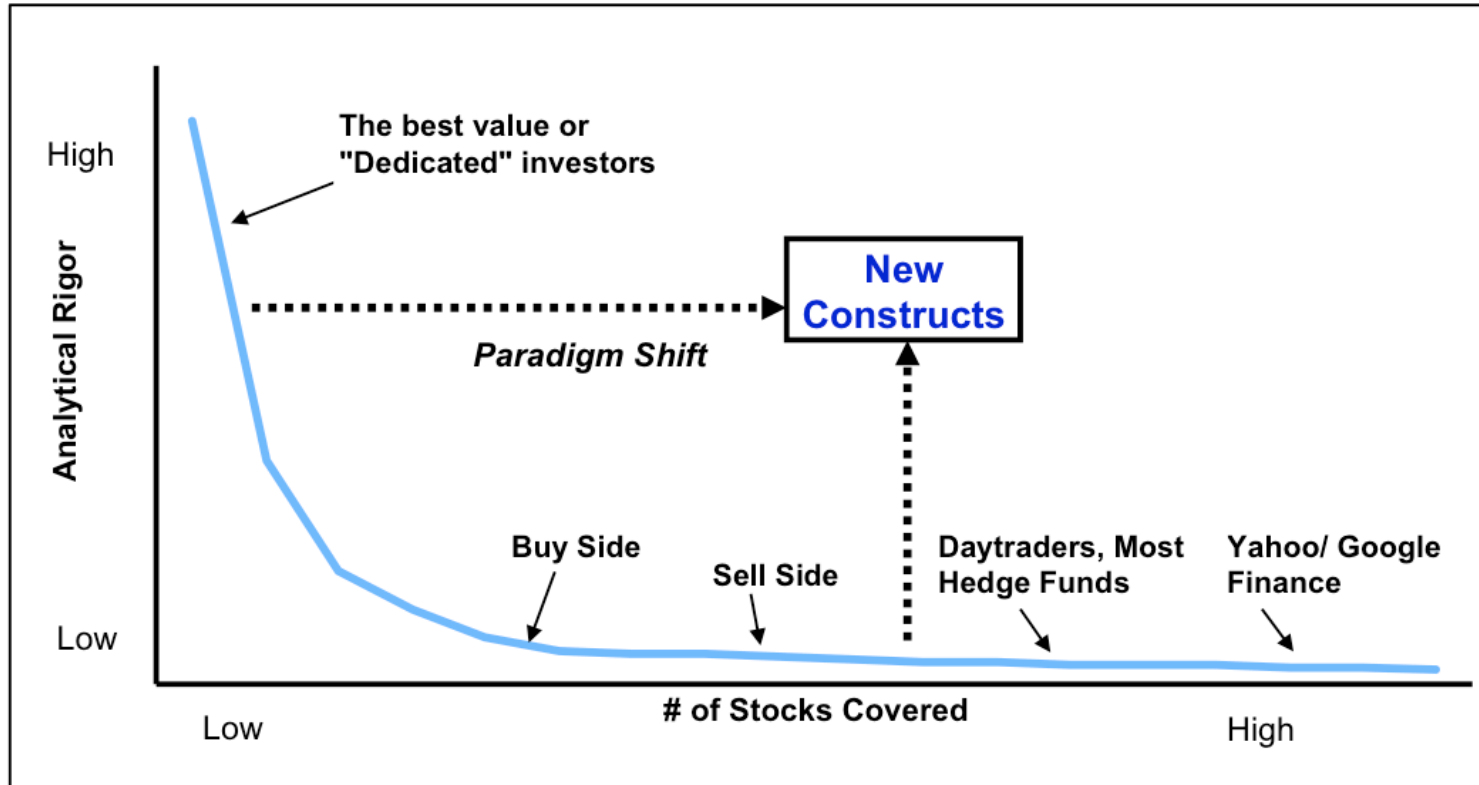
1. “20% of CFOs say earnings are fudged”
2. “Magnitude of misrepresentation is... 10%”
3. [sell side] “Analysts usually don’t actively detect poor earnings quality.”

[Financial Times 8/12/2015](#): Wall Street analyst confesses

1. “[Why a buy is not really a buy](#)” – Integrity Research
2. “Brown-Nosed Buy”, “Client Driven Buy”, “Industry Buy” and “Neglect”
3. Ignored by institutional investors, dangerous to the rest

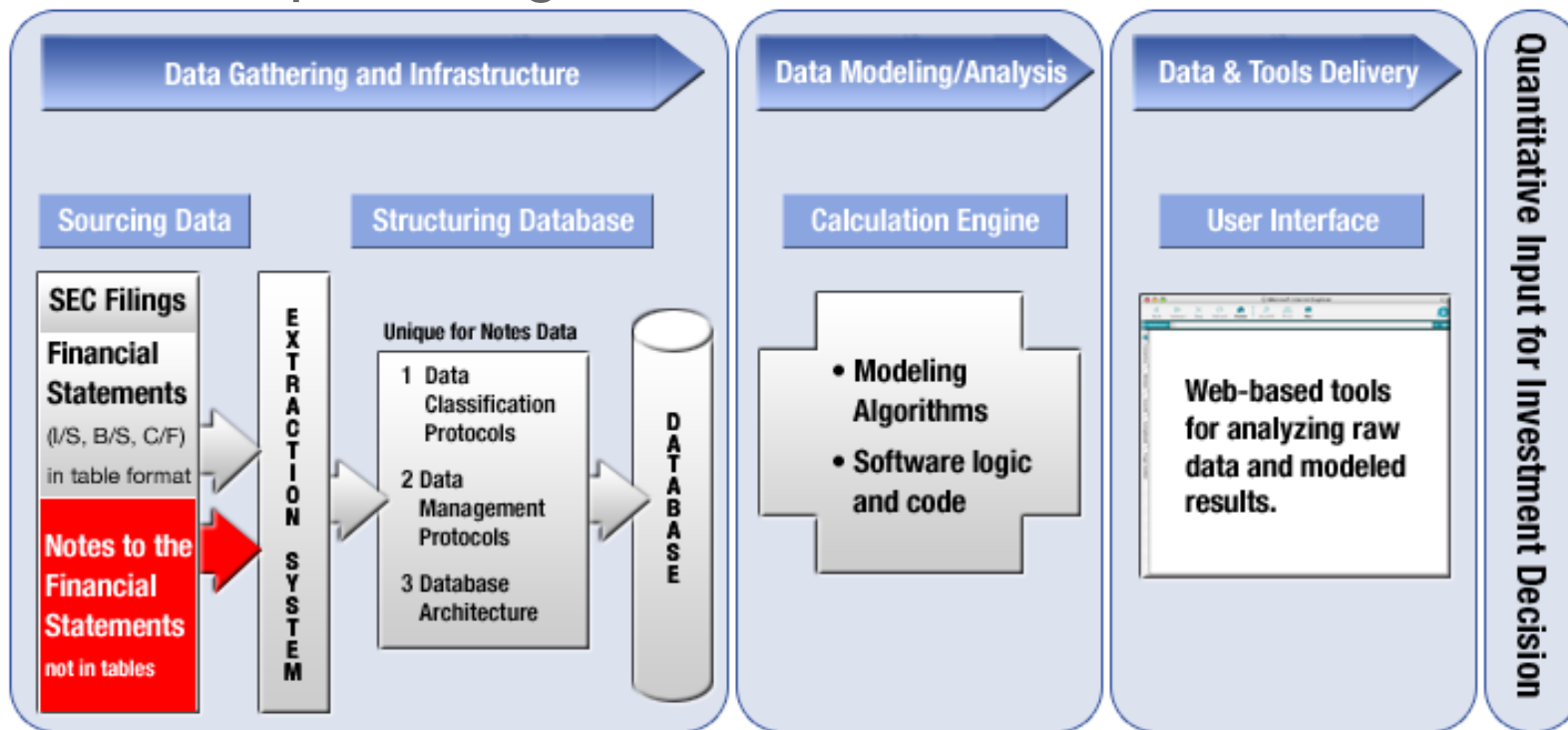
So What Has Changed?

Technology has changed



Proprietary Research Platform

Focus: Exploit Insights from Footnotes on 3000+ Stocks



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.

Database of Human-Validated Parsing Instructions

80,000+ Filings of Testing & Perfecting

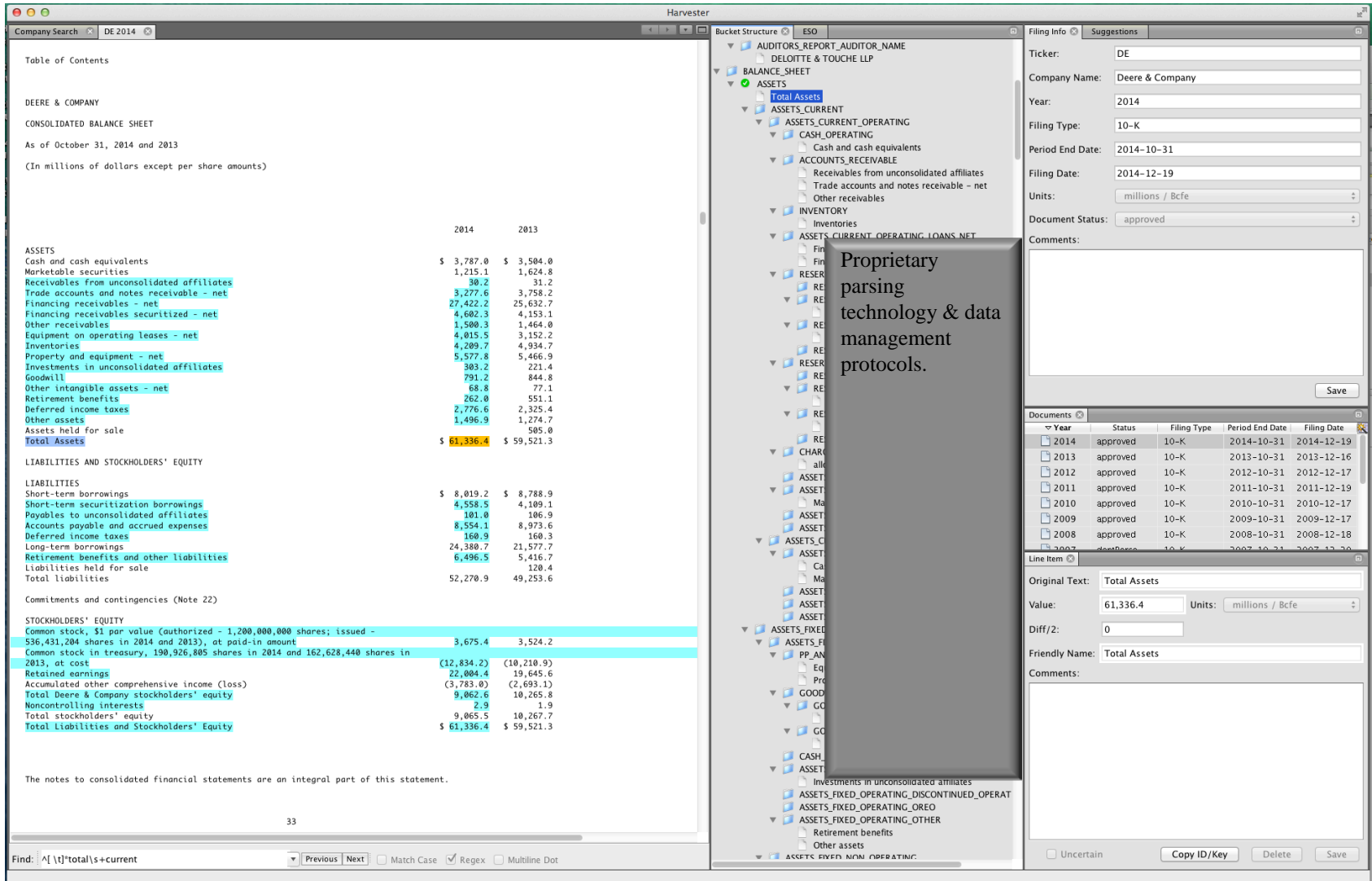
1. Analysts shine lights in dark corners of filings.
2. Technology records every step of the parsing process.
3. Machines learn how to parse based on what expert analysts have done.

“If an analyst has parsed an item the same way 80,000 times, then we no longer need an analyst to parse that line item.

The machine can do it.”

Proprietary Research Platform

Financial Expertise meets technology expertise.



The screenshot displays the Harvester financial research platform interface. The main window shows a consolidated balance sheet for Deere & Company as of October 31, 2014 and 2013. The balance sheet is presented in a table format with columns for 2014 and 2013. The assets section includes Cash and cash equivalents, Marketable securities, Receivables from unconsolidated affiliates, Trade accounts and notes receivable - net, Financing receivables - net, Financing receivables securitized - net, Other receivables, Equipment on operating leases - net, Inventories, Property and equipment - net, Investments in unconsolidated affiliates, Goodwill, Other intangible assets - net, Retirement benefits, Deferred income taxes, Other assets, and Assets held for sale. The liabilities and stockholders' equity section includes Short-term borrowings, Short-term securitization borrowings, Payables to unconsolidated affiliates, Accounts payable and accrued expenses, Deferred income taxes, Long-term borrowings, Retirement benefits and other liabilities, Liabilities held for sale, and Total liabilities. The stockholders' equity section includes Common stock, Retained earnings, Accumulated other comprehensive income (loss), Total Deere & Company stockholders' equity, Noncontrolling interests, and Total stockholders' equity. The total assets and total liabilities and stockholders' equity are both \$61,336.4 million for 2014 and \$59,521.3 million for 2013.

On the right side of the interface, there is a 'Bucket Structure' tree showing the hierarchy of financial data. The tree includes categories such as AUDITORS_REPORT_AUDITOR_NAME, BALANCE_SHEET, ASSETS, ASSETS_CURRENT, ASSETS_CURRENT_OPERATING, CASH_OPERATING, ACCOUNTS_RECEIVABLE, INVENTORY, and ASSETS_CURRENT_OPERATING_LOANS_NET. A 'Proprietary parsing technology & data management protocols.' overlay is visible over the bucket structure tree.

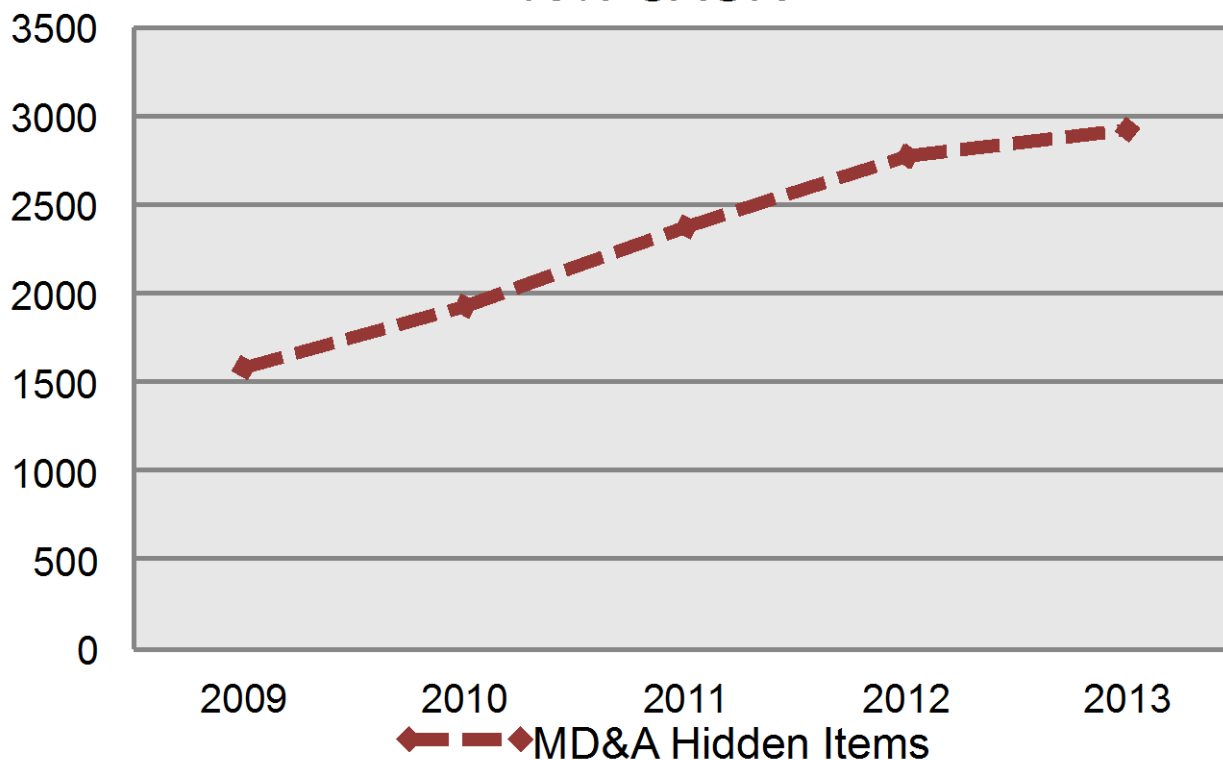
Below the bucket structure tree, there is a 'Filing Info' section with fields for Ticker (DE), Company Name (Deere & Company), Year (2014), Filing Type (10-K), Period End Date (2014-10-31), Filing Date (2014-12-19), Units (millions / Bcfe), and Document Status (approved). There is also a 'Comments' section with a text area and a 'Save' button.

At the bottom of the interface, there is a 'Documents' section with a table showing a list of documents. The table has columns for Year, Status, Filing Type, Period End Date, and Filing Date. The documents listed include 2014, 2013, 2012, 2011, 2010, 2009, and 2008, all with a status of 'approved' and a filing type of '10-K'.

At the bottom right, there is a 'Line Item' section with fields for Original Text (Total Assets), Value (61,336.4), Units (millions / Bcfe), Diff/2 (0), Friendly Name (Total Assets), and Comments. There are also buttons for 'Copy ID/Key', 'Delete', and 'Save'.

More Needles, Bigger Haystacks

Material Hidden Items
16% CAGR



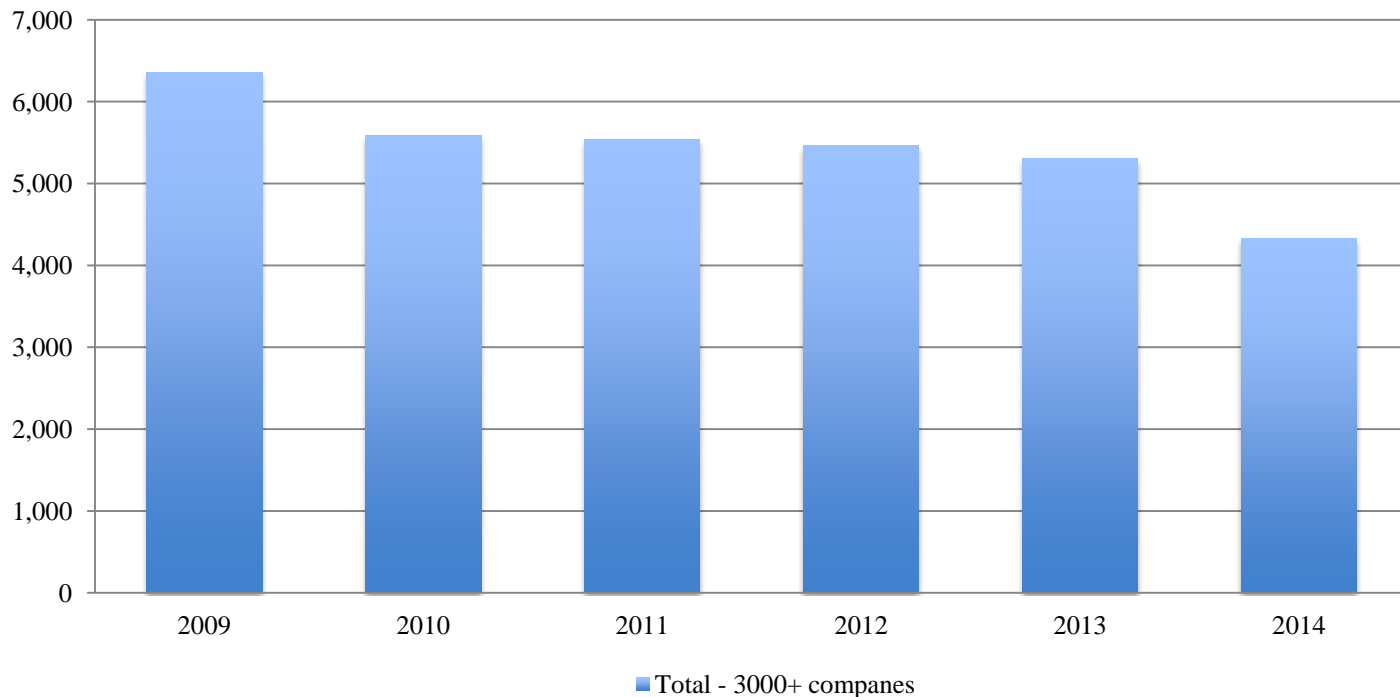
Items found only in the MD&A (e.g. gains, charges, deferred items, etc) that distort income statement results are rising rapidly.

Large Asset Write-Downs – A Red Flag

32,583

Over the last 5+ Years, we found 32,583 write-downs.

of Write-Downs

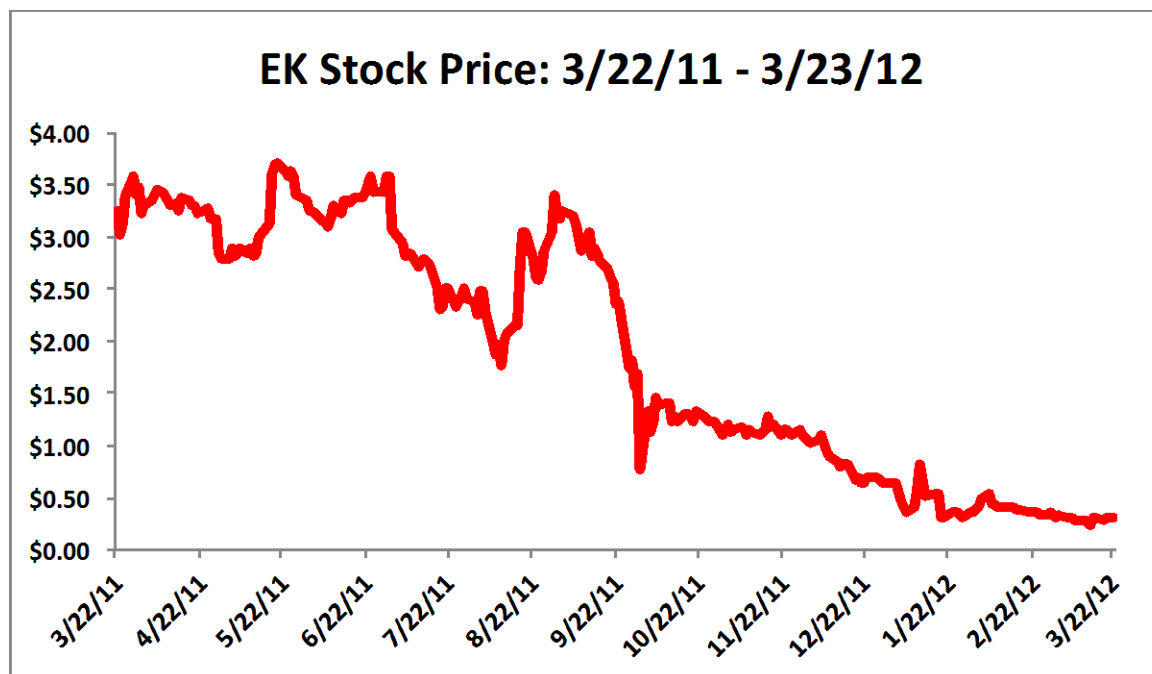


Early Indicator for Bankruptcy

Report on Eastman Kodak (EKDKQ.PK) on 3/21/2011

2010 10-K Revealed Abnormal Pension Assumptions

1. 2.2% of revs from pension, abnormally high return on plan asset assumption 8.7%
2. Underfunded by \$2.6bn or 3x the market cap at the time
3. Valuation implied 10% CAGR in NOPAT for 11 years
4. Down 90% while S&P 500 was down ~3%, no longer under coverage



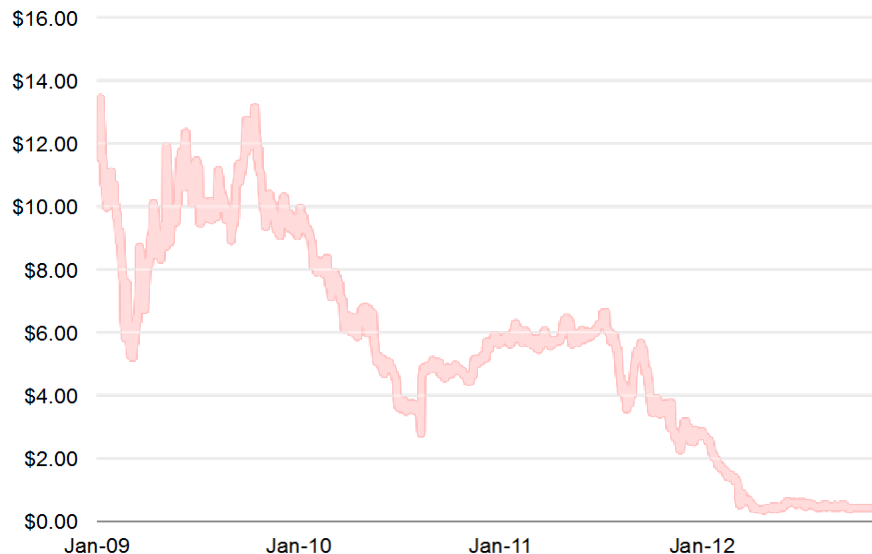
*This graph was created based on information collected and analyzed by New Constructs, LLC. New Constructs regularly gathers information from over 3,000 companies' 10Ks, including the Notes to the Financial Statements and MD&A.

Early Indicator for Fraud

Dynegy (DYN) Fraud Case 2012 – Defrauding Creditors

1. Asset transfer in subsidiaries found to be fraudulent
2. Benefited activist investor Carl Icahn, with two board representatives at DYN
3. New Constructs rating before fraud charges: Very Dangerous
4. Write-Downs in 3-yrs prior to fraud: 16 charges totaling \$3.85bn (346% net assets)

DYN - stock price



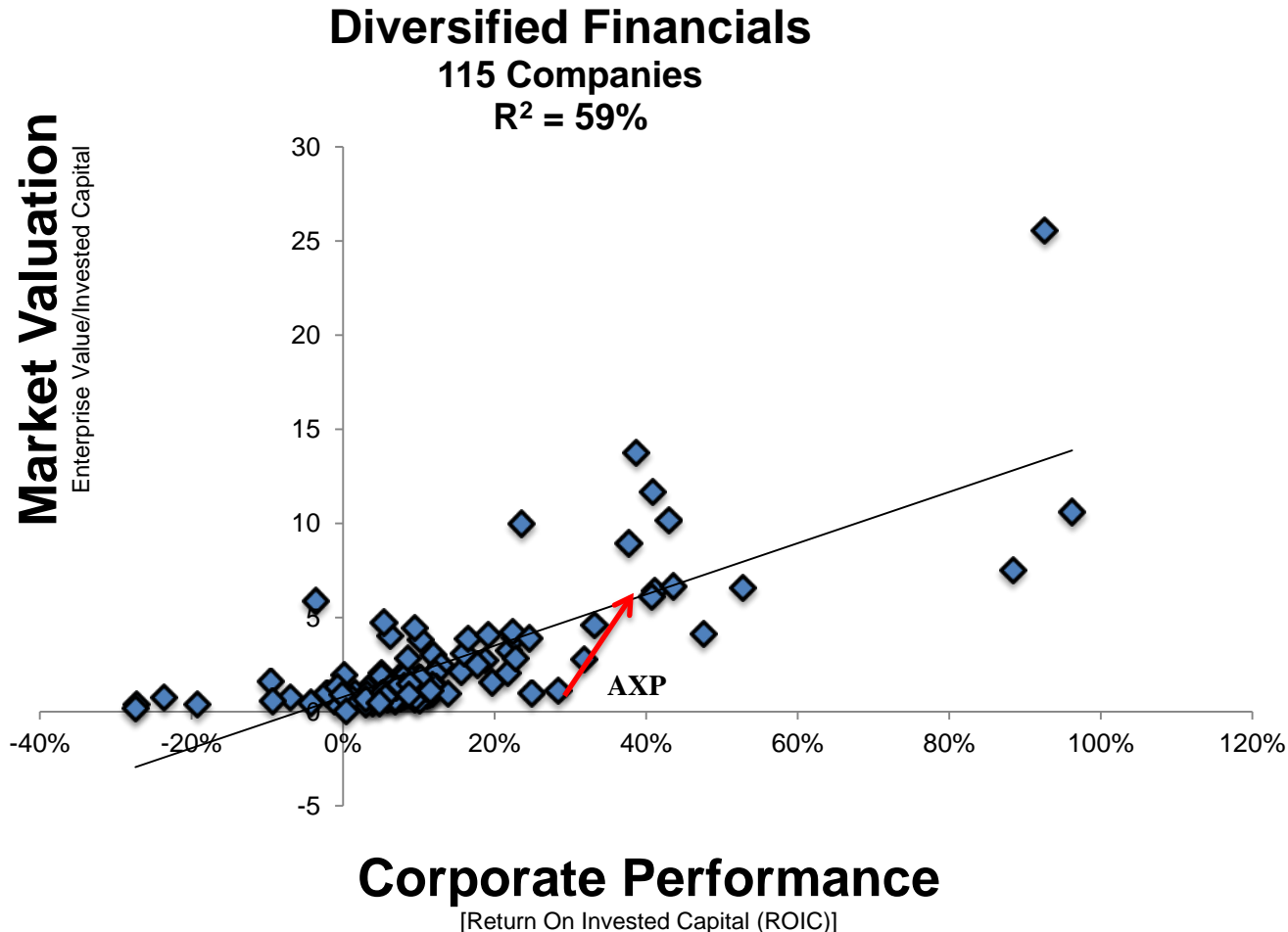
Proof Is In Performance

Publish Date	Company	Ticker	Performance	S&P Since Publish Date	Out Performance Vs the S&P
2/23/15	Tailored Brands	TLRD	-74%	-12%	64%
8/18/15	SolarCity	SCTY	-64%	-11%	54%
3/23/15	El Pollo Loco	LOCO	-57%	-12%	48%
6/23/15	Demandware	DWRE	-58%	-13%	47%
1/27/15	Box, Inc.	BOX	-52%	-8%	46%
10/5/15	Marketo	MKTO	-51%	-7%	46%
6/1/15	Twitter	TWTR	-55%	-12%	45%
7/7/15	Splunk	SPLK	-53%	-11%	44%
12/14/15	Qlik Technologies	QLIK	-39%	-8%	32%
6/30/14	Valeant Pharmaceuticals	VRX	-33%	-3%	30%
11/3/15	ServiceNow	NOW	-37%	-12%	27%
4/20/15	Newfield Exploration	NFX	-37%	-12%	27%
2/16/15	ICON Healthcare A	ICHAX	-34%	-12%	25%
11/9/15	Celadon Group	CGI	-33%	-11%	25%
10/12/15	Proofpoint	PFPT	-30%	-8%	24%
6/9/15	Groupon	GRPN	-30%	-11%	21%
9/29/15	KB Home	KBH	-20%	-1%	21%
2/9/15	CenturyLink	CTL	-27%	-9%	20%
5/4/15	Sonic Automotive	SAH	-30%	-12%	19%
11/23/15	Textron	TXT	-24%	-11%	15%
5/18/15	RidgeWorth Mid-Cap Value	SAMVX	-24%	-10%	13%
7/13/15	Speedway Motorsports	TRK	-21%	-12%	11%
12/7/15	Square	SQ	-20%	-11%	11%
9/21/15	Snyder's-Lance	LNCE	-13%	-6%	9%
1/19/15	Biglari Holdings	BH	-14%	-8%	8%
10/19/15	Saratoga Financial Service	SFPAX	-13%	-9%	6%
9/14/15	Expedia	EXPE	-9%	-5%	6%
8/5/15	Planet Fitness	PLNT	-14%	-12%	4%
7/28/15	Chartwell Small Cap Value	CWSVX	-12%	-9%	4%
2/8/16	Pure Storage	PSTG	-1%	0%	4%
2/1/16	WhiteWave Foods	WWAV	-1%	-4%	-1%
5/11/15	Intersil	ISIL	-7%	-12%	-3%
4/13/15	athenahealth	ATHN	0%	-11%	-9%
3/16/15	Pinnacle Foods	PF	3%	-11%	-12%
4/27/15	Briggs & Stratton	BGG	6%	-12%	-16%
10/26/15	Jarden Corp	JAH	8%	-10%	-16%
3/30/15	Wayfair	W	15%	-11%	-24%
2/2/15	Netflix	NFLX	41%	-8%	-47%
Average			-24%	-9%	17%

[Full report details are here.](#)

Sector/Industry Detail and Benchmarks

Big Picture Supported By Individual Company Models



Recognized By Top Clients & Media

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



Case Study:
Open Letter To Larry Ellison
How To Boost ORCL by \$65 Billion

Case Study: Oracle (ORCL)

Thesis:

Management can boost the market value of ORCL by aligning the firm's strategy and performance compensation with real cash flows or what we call return on invested capital (ROIC).

Our thesis is predicated on the ideas that (a) real cash flows matter and (b) superior profitability is ultimately rewarded by the market.

Case Study: Oracle (ORCL)

Figure 1: Value Creation Potential for ORCL Management

\$ in millions except per share amounts	Sustain Current Level	Scenario 1	Scenario 2	Scenario 3
ROIC	23%	24%	26%	27%
Implied Share Price	\$42.38	\$45.43	\$49.24	\$52.33
% Gain Over Current Price	16%	24%	34%	43%
Gain over Current Market Value	\$24,171	\$36,975	\$55,981	\$65,979

We support our thesis by showing:

- How undervalued ORCL is relative to real cash flows and ROIC
- How to ensure the market rewards a higher ROIC
- Targeted proposals on how management can improve ROIC
- How to quantify the size of the prize if management improves ROIC

Appendix

We help you: Find Safe Stocks

1. [Most Attractive Stocks](#) – monthly newsletter
2. [Long Ideas](#) – weekly reports on our blog
 - [“10 Stocks To Get You Through A Bear Market”](#)
 - [“The Market Values High ROIC Companies”](#)
 - [“High ROIC Stocks Outperformed in 2008”](#)
 - [“Long Idea: Allegiant Travel Company \(ALGT\)”](#)
3. [Education Center](#) – get details, transparency

We help you: Find Dangerous Stocks

1. [Most Dangerous Stocks](#) – monthly newsletter
2. [Danger Zone](#) – weekly reports on our blog
 - [“Danger Zone: WhiteWave Foods \(WWAV\)”](#)
 - [“Suspended Ratings”](#)
 - [“Danger Zone: Lowlights From 2015”](#)
 - [“Why PE Ratios Are Not A Good Measure Of Value”](#)
3. [Forensic Accounting](#) – get details, transparency

We help you: Find Safe Funds

1. [Best & Worst Sector Funds](#)— quarterly newsletter
2. [Best & Worst Style Funds](#)— quarterly newsletter
3. [Sector Ratings](#)
4. [Unique Methodology](#) — get details, transparency

Free Resources

1. [Free research](#), alerts and updates
2. Free [Education](#)
3. Free [Tutorials](#)
4. See our [models](#)
 - 100% transparency
 - Directly linked to SEC filings
 - 100% customizable

Proof Is In Performance

Performance Tracking— quarterly newsletter

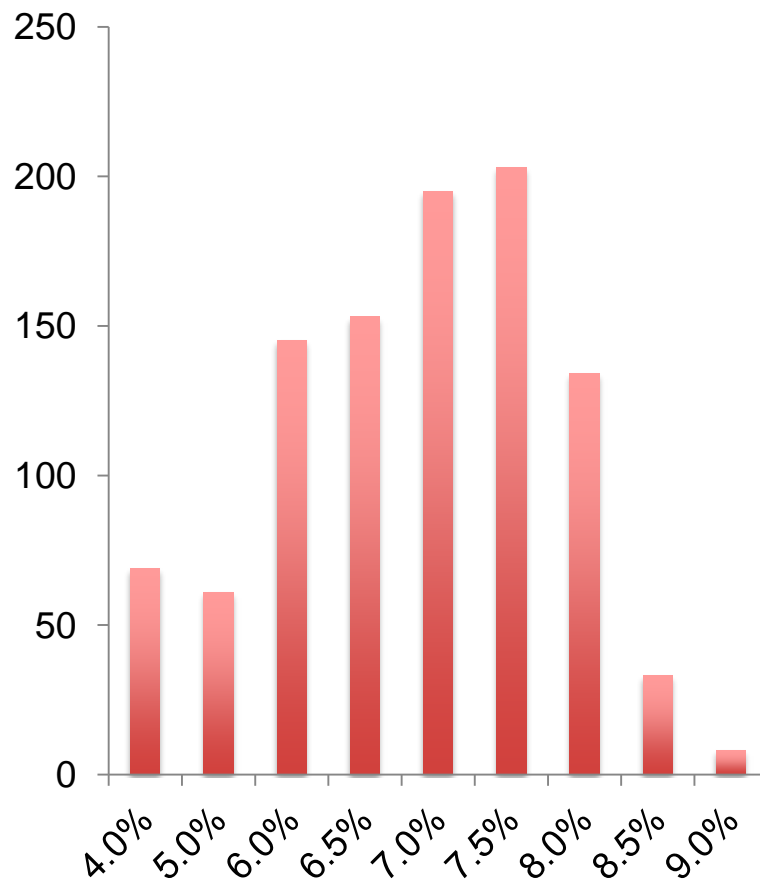
- Honest
- Direct
- Diligent
- Accountable

Don't Just Take My Word For It – You Don't Have To.

Management's Influence on Profits

Micro and Macro Views

Distribution of Return On Plan Asset Assumptions



Auditors & investors need to know this data.

- Raising the expected Return on Plan Assets (EROPA) reduces reported pension expense.
- The mean EROPA for 2014 was 6.5%. Roughly 55% of companies expect a long-term return on plan assets between 6.5% and 7.5%.
- Virtusa Corp (VRTU) has the most aggressive assumptions, with EROPA of 10.38%, followed by Exlservice Holdings (EXLS) at 9%.

Basic Services

Coverage

3000+ Stocks	400+ ETFs	7000+ Mutual Funds
Updated Daily	Updated Daily	Updated Daily
Ratings & Reports	Ratings & Reports	Ratings & Reports
Screeners	Screeners	Screeners
Monthly Newsletter	Qrtly Newsletter	Qrtly Newsletter
Pick of the Week	Pick of the Week	Pick of the Week
Portfolio Reviews	Portfolio Reviews	Portfolio Reviews
Alerts	Alerts	Alerts
Web/mobile	Web/mobile	Web/mobile
Email	Email	Email
Custom data/reports	Custom data/reports	Custom data/reports

Protection

Idea
Generation

Monitoring

Access

Detailed Ratings, Models and Reports

Intel Corporation (INTC) : \$29.76 at close on Jan 15, 2016

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Economic vs Reported EPS	Return on Invested Capital (ROIC)	FCF Yield	Price-to-EBV Ratio	Growth Appreciation Period (GAP)
Very Dangerous	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Dangerous	False Positive	4th Quintile	-5% < -1%	2.4 < 3.5 or < -1	20 < 50
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3

Actual Values					
INTC	\$1.13 vs. \$2.34	15%	6%	1.0	< 1

Benchmarks					
S&P 500 (SPY)	Positive EE	19%	2%	2.8	25
Russell 2000 (IWM)	Positive EE	6%	-1%	3.3	31

[Company Model](#)
[Download Report](#)

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Add up to 50 tickers at a time to your portfolio.

Portfolio: My Portfolio (default) ▾ » Edit » Alerts Add Ticker(s): Add

Ticker ▲	Name	Type	Sector / Category	Price ¹	Mkt Val / AUM ²	Overall Rating	Report / Details	ROIC	FCF Yield	Price to EBV	GAP	Analyst Notes ³	Remove
AAPL	Apple Inc.	Stock	Information Technology	\$118.90	\$697,329	Attractive		177%	6%	1.1	> 100		✖
ABCO	The Advisory Board Company	Stock	Industrials	\$47.33	\$1,704	Dangerous		5%	-8%	6.5	> 100	Upgraded: Jan 22 Most Dangerous	✖
AIG	American International Group, Inc.	Stock	Financials	\$49.26	\$68,960	Attractive		6%	15%	0.8	< 1	Upgraded: Jan 16	✖
AMZN	Amazon.com Inc.	Stock	Consumer Discretionary	\$311.78	\$144,356	Dangerous		1%	-4%	-16.1	> 100	Upgraded: Jan 22	✖
BA	The Boeing Company	Stock	Industrials	\$147.78	\$105,357	Attractive		14%	6%	1.7	19	Poor Disclosure	✖
BBH	Van Eck Market Vectors Biotech ETF	ETF	Health Care	\$123.37	\$727	Neutral		16%	-1%	5.3	55		✖
BCSIX	Brown Capital Management Mutual Funds: Brown Capital Management Small	Mutual Fund	Small Cap Growth	\$70.01	\$2,634	Neutral		19%	0%	4.8	79		✖
BFAM	Bright Horizons Family Solutions, Inc.	Stock	Consumer Discretionary	\$49.16	\$3,238	Very Dangerous		6%	-3%	25.2	79		✖
CI	CIGNA Corporation	Stock	Health Care	\$109.62	\$28,674	Very Attractive		16%	4%	1.0	2	Most Attractive	✖
CRM	salesforce.com Inc.	Stock	Information Technology	\$58.10	\$36,661	Dangerous		-2%	-4%	-8.6	> 100	Upgraded: Jan 22 Most Dangerous	✖

Overview/Background

Independent Proprietary Research & Diligence

New Constructs, LLC

- Founded July 2002
- Top-rated research by [Barron's](#)
- Deep, financial accounting expertise
- Patented research technology
- Footnotes expertise is a competitive advantage
- Integrated ratings for 3000 stocks, 400 ETFs and 7000 mutual funds

David Trainer:

Former auditor with Arthur Andersen and equity analyst at Credit-Suisse, Mr. Trainer is the CEO of New Constructs, LLC. He leverages his accounting and finance expertise with proprietary technology that gleans insights from over 70,000 10-K filings.

Mr. Trainer also serves on FASB's [Investor Advisory Committee](#), where he helps shape new and existing accounting rules. He has also advised the Senate Banking Committee and the subcommittee for Securities, Insurance and Investments.

He is a Wall Street veteran and corporate finance expert.

He is author of [Modern Tools for Valuation](#) (Wiley Finance 2010).

What Do We Mean by “Independent and Unbiased”?

We Provide A True Investor Perspective

No banking, advisory or Wall Street ties – none

- Access our raw data via **Marked-up filings**: [download a sample](#).

Unadulterated expertise in accounting, finance and SEC filings.

Value Proposition

We find it. You benefit.

1. Best fundamental data in the business
2. Best earnings quality and valuation models
3. Best protection from devils in details of SEC filings
 - Led by top **accounting & finance expertise** leveraging the best technology

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