



New Stocks on Exec Comp & ROIC Model Portfolio: May 2017

Four new stocks make [May's Exec Comp Aligned With ROIC Model Portfolio](#), available to members as of 5/17/17.

Recap from April's Picks

Our Exec Comp Aligned With ROIC Model Portfolio (-1.2%) underperformed the S&P 500 (+3.2%) last month. The best performing stock in the portfolio was Lear Corp (LEA), which was up 11%. Overall, six out of the 15 Exec Comp To ROIC Stocks outperformed the S&P in April and eight stocks had positive returns.

Since inception, this model portfolio is up 22% while the S&P 500 is up 14%.

The success of this Model Portfolio highlights the value of our [Robo-Analyst technology](#), which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.

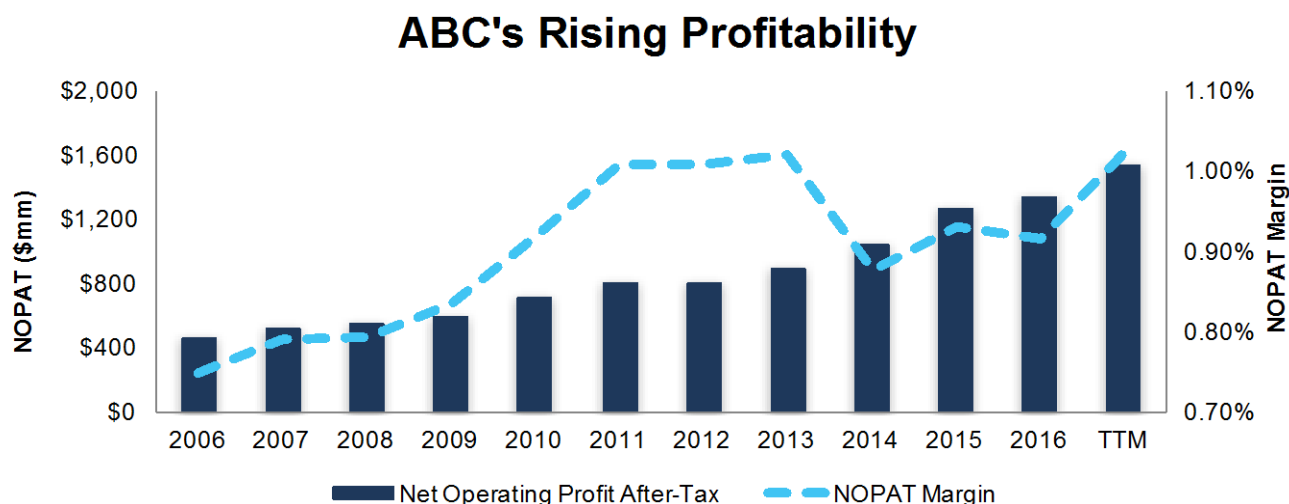
This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital ([ROIC](#)) is the [primary driver of shareholder value creation](#).

New Stock Feature for May: AmerisourceBergen Corp (ABC: \$89/share)

AmerisourceBergen Corp (ABC), a wholesale pharmaceutical distributor, is one of the additions to our Exec Comp Aligned With ROIC Model Portfolio in May.

Over the past decade, AmerisourceBergen has grown revenue by 9% compounded annually. Over the same time, the company has grown after-tax profit ([NOPAT](#)) by 11% compounded annually to \$1.3 billion in 2016. NOPAT has grown to \$1.5 billion over the last twelve months (TTM). Per Figure 1, NOPAT margins have also improved from 0.7% in 2006 to 1% TTM and have recovered from the dip in 2014.

Figure 1: AmerisourceBergen's Decade of Profit Growth



Sources: New Constructs, LLC and company filings

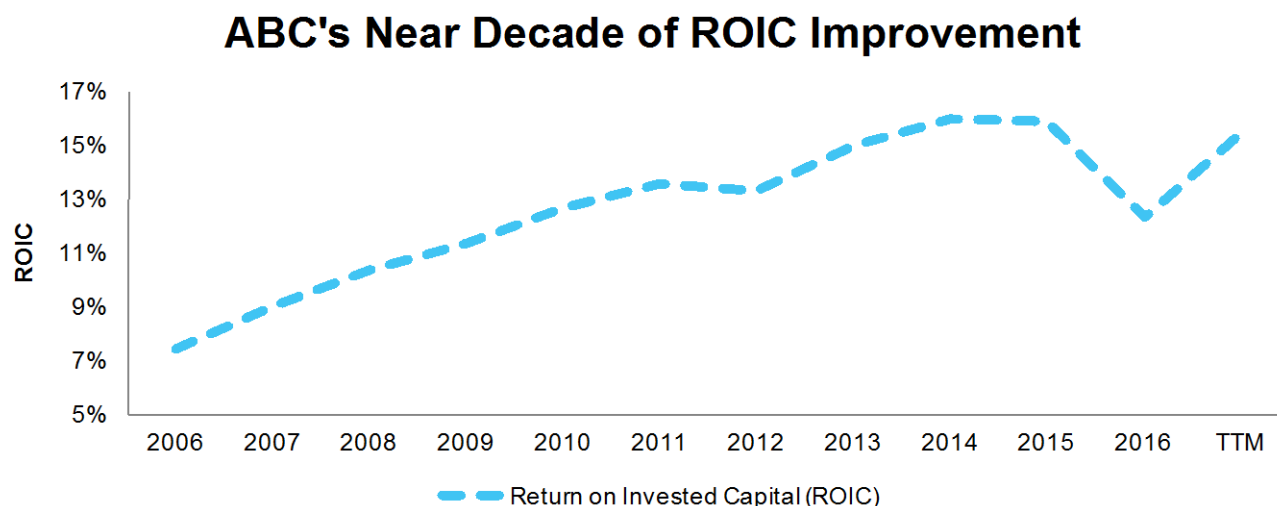
AmerisourceBergen currently earns a top-quintile 15% return on invested capital ([ROIC](#)) and generated \$875 million (4% of market cap) in [free cash flow](#) over the last twelve months. This free cash flow generation equates to a 3% [FCF yield](#).

Executive Compensation Plan Incentivizes Shareholder Value Creation

AmerisourceBergen has aligned executive compensation with ROIC since 2008, when it replaced return on committed capital as a performance metric. In 2016, 25% of performance share awards were based on a three-year average ROIC. Performance shares represent 40% of an executive's equity incentive plan.

The focus on ROIC helps ensure executives are good stewards of capital. Per Figure 3, AmerisourceBergen has improved its ROIC from 7% in 2006 to 15% TTM.

Figure 2: Improving ROIC Improves Shareholder Value



Sources: New Constructs, LLC and company filings

We've detailed ways in which ROIC is directly correlated to changes in shareholder value [here](#). ABC's use of return on invested capital to measure performance ensures executives' interests are aligned with shareholders' interests.

ABC Is Undervalued Despite Strong Fundamentals

ABC is up 134% over the past five years, while the S&P is up 80% over the same time. However, ABC has fallen 25% over the past two years despite continued NOPAT growth. After the large price decline, ABC is significantly undervalued.

At its current price of \$89/share, ABC has a price to economic book value ([PEBV](#)) ratio of 0.7. This ratio means the market expects ABC's NOPAT to permanently decline by 30%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 13% compounded annually since 2006.

Even if ABC were to never again grow profits from current levels, the [economic book value](#), or no growth value of the firm is \$130/share – a 46% upside from the current valuation.

However, if ABC can maintain current NOPAT margins (1%) and [grow NOPAT by just 6% compounded annually for the next decade](#), the stock is worth \$148/share today – a 66% upside.

Impacts of Footnotes Adjustments and Forensic Accounting

Our [Robo-Analyst technology](#) enables us to perform forensic accounting with scale and provide the [research needed](#) to fulfill fiduciary duties. In order to derive the [true recurring cash flows](#), an accurate [invested capital](#), and a real shareholder value, we made the following adjustments to AmerisourceBergen's 2016 10-K:

Income Statement: we made \$1.4 billion of adjustments, with a net effect of removing \$82 million in non-operating income (<1% of revenue). We removed \$728 million in [non-operating income](#) and \$646 million in [non-operating expenses](#). You can see all the adjustments made to ABC's income statement [here](#).



Balance Sheet: we made \$3.4 billion of adjustments to calculate invested capital with a net increase of \$2.6 billion. One of the largest adjustments was \$1.6 billion due to [total reserves](#). This adjustment represented 19% of reported net assets. You can see all the adjustments made to ABC's balance sheet [here](#).

Valuation: we made \$7.3 billion of adjustments with a net effect of decreasing shareholder value by \$7.3 billion. There were no adjustments that increased shareholder value. Apart from [total debt](#), which includes \$264 million in off-balance sheet [operating leases](#), one of the largest adjustments to shareholder value was \$2.3 billion in [deferred tax liabilities](#). This adjustment represents 12% of ABC's market cap. Despite the net decrease in shareholder value, ABC remains undervalued.

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Disclosure: David Trainer, Kyle Guske II, and Kenneth James receive no compensation to write about any specific stock, style, or theme.

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4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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