Model Portfolio: September 2017: Exec Comp Aligned with ROIC

15 Large/Mid/Small Cap Stocks

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- **Figure 1 shows four new stocks that make our September list.**
- **The Executive Compensation Aligned with ROIC Portfolio (+2.1%) outperformed the S&P 500 (+1.2%) last month.**
- **Since inception, this model portfolio is up 19% while the S&P 500 is up 19%.**
- **Figure 8 shows the nine stocks that outperformed from August's report.**
- **The stocks in this model portfolio earn an Attractive or Very Attractive rating. All of the companies have executive compensation plans that are aligned with return on invested capital (ROIC).**
- **ROIC is by far the biggest driver of stock valuation.**

Figure 1: Additions for September

Portfolio Additions	
Ticker	**Company Name**
CLX	The Clorox Company
JBSS	John B. Sanfilippo & Son
KBAL	Kimball International
PEP	PepsiCo Inc.

Sources: New Constructs, LLC

This model portfolio is updated around the 15th of every month.

Please see Appendix B for explanations of additions and deletions to the Executive Compensation Aligned With ROIC Model Portfolio.

The 5 "Accurate ROIC Calculation/Strong Alignment with Exec Comp" Stocks for September

We recommend that investors equal-weight holdings in all 5 stocks.

Figure 2: 5 Accurate ROIC Calculation/Strong Alignment with Exec Comp Stocks for September

			High-Quality Earnings		Cheap Valuation				Executive Compensation Plans Aligned with ROIC
			As of Last Twelve Months		as of 9/13/17				
Ticker	Company Name	Sector	Positive Economic EPS	Return On Invested Capital (ROIC)	Positive Free Cash Flow Yield	Low Price-to-Economic Book Value	Short Market-Implied GAP (years)	Market Value ($mm)	Proxy Statement
NVR	NVR INC.	Consumer Discretionary	$102.50	21%	4%	1.2	2	$10,451	NVR Proxy Statement
KMB	Kimberly-Clark Corp	Consumer Staples	$4.80	17%	4%	1.1	2	$42,389	KMB Proxy Statement
SMP	Standard Motor Products	Consumer Discretionary	$1.72	12%	4%	0.9	Less than 1	$1,059	SMP Proxy Statement
JBSS*	John B. Sanfilippo & Son	Consumer Staples	$2.04	12%	6%	1.0	3	$719	JBSS Proxy Statement
PEP*	PepsiCo Inc.	Consumer Staples	$3.58	11%	4%	1.0	2	$163,150	PEP Proxy Statement

* Addition to the list in September

Stocks are ranked by ROIC in Descending Order

Sources: New Constructs, LLC

The 5 "Flawed ROIC Calculation/Strong Alignment with Exec Comp" Stocks for September

We recommend that investors equal-weight holdings in all 5 stocks.

Figure 3: 5 Flawed ROIC Calculation/Strong Alignment with Exec Comp Stocks for September

			High-Quality Earnings (As of Last Twelve Months)		Cheap Valuation (as of 9/13/17)				Executive Compensation Plans Aligned with ROIC
Ticker	**Company Name**	**Sector**	**Positive Economic EPS**	**Return On Invested Capital (ROIC)**	**Positive Free Cash Flow Yield**	**Low Price-to-Economic Book Value**	**Short Market-Implied GAP (years)**	**Market Value ($mm)**	**Proxy Statement**
HAS	Hasbro Inc.	Consumer Discretionary	$3.46	17%	5%	1.1	1	$12,003	HAS Proxy Statement
STX	Seagate Technology	Information Technology	$2.31	17%	15%	0.7	1	$9,566	STX Proxy Statement
KBAL*	Kimball International	Consumer Discretionary	$0.59	17%	8%	1.1	5	$653	KBAL Proxy Statement
GWW	W.W. Grainger Inc.	Industrials	$8.01	14%	8%	0.8	Less than 1	$9,721	GWW Proxy Statement
PLCE	Childrens Place Inc.	Consumer Discretionary	$4.19	11%	5%	0.9	Less than 1	$2,028	PLCE Proxy Statement

* Addition to the list in September

Stocks are ranked by ROIC in Descending Order

Sources: New Constructs, LLC

The 5 "Weak Alignment with Exec Comp" Stocks for September

We recommend that investors equal-weight holdings in all 5 stocks.

Figure 4: 5 Weak Alignment with Exec Comp Stocks for September

			High-Quality Earnings As of Last Twelve Months		Cheap Valuation as of 9/13/17				Executive Compensation Plans Aligned with ROIC
Ticker	**Company Name**	**Sector**	**Positive Economic EPS**	**Return On Invested Capital (ROIC)**	**Positive Free Cash Flow Yield**	**Low Price-to-Economic Book Value**	**Short Market-Implied GAP (years)**	**Market Value ($mm)**	**Proxy Statement**
SBUX	Starbucks Corporation	Consumer Discretionary	$1.70	23%	4%	1.6	6	$78,389	SBUX Proxy Statement
ORLY	O'Reilly Automotive Inc.	Consumer Discretionary	$9.28	21%	5%	1.1	1	$18,308	ORLY Proxy Statement
ABC	AmerisourceBergen Corp	Health Care	$4.94	16%	4%	0.7	Less than 1	$18,475	ABC Proxy Statement
CLX*	The Clorox Company	Consumer Staples	$4.09	12%	4%	1.0	Less than 1	$17,306	CLX Proxy Statement
ESRX	Express Scripts Inc.	Health Care	$3.43	11%	9%	0.6	Less than 1	$36,524	ESRX Proxy Statement

* Addition to the list in September

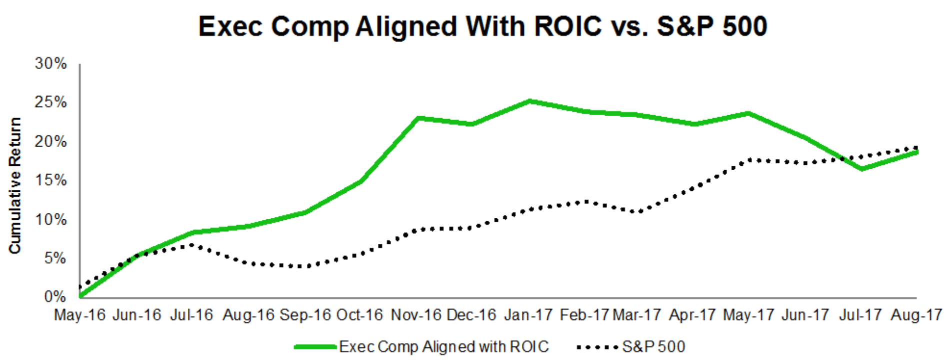
Stocks are ranked by ROIC in Descending Order

Sources: New Constructs, LLC

Exec Comp Aligned with ROIC: Overall Performance

Per Figure 5, The Exec Comp Aligned with ROIC Portfolio has matched the S&P 500 since inception in May 2016. Since then, the Exec Comp Aligned with ROIC Portfolio has cumulative returns of 19% compared to 19% for the S&P 500. A detailed breakdown of last month's performance can be seen on the next page.

Figure 5: Performance of Exec Comp Aligned with ROIC Model Portfolio



Sources: New Constructs, LLC
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

Figure 6: Monthly Return of Exec Comp Aligned with ROIC

Portfolio Returns					
	2016	1Q17	2Q17	17-Jul	17-Aug
Exec Comp Aligned With ROIC	22.3%	1.1%	-2.9%	-3.9%	2.1%
SP 500	9.0%	2.0%	6.4%	0.7%	1.2%

Sources: New Constructs, LLC
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

Figure 7: Cumulative Return of Exec Comp Aligned with ROIC

Cumulative Portfolio Returns					
	2016	1Q17	2Q17	17-Jul	17-Aug
Exec Comp Aligned With ROIC	22.3%	23.4%	20.5%	16.6%	18.7%
S&P 500	9.0%	11.0%	17.4%	18.1%	19.3%

Sources: New Constructs, LLC
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

Exec Comp Aligned with ROIC: Monthly Updates

The Exec Comp Aligned With ROIC Portfolio (+2.1%) outperformed the S&P 500 (+1.2%) last month. Nine stocks from our August Exec Comp Aligned with ROIC lists outperformed the S&P 500, and 11 stocks had positive returns. See Figure 8 for details. For updates on the performance of all of last month's stocks, see Appendix A. We measure our August performance based on closing prices from August 16, 2017 to September 13, 2017. We published last month's report to subscribers on August 16, 2017.

Figure 8: 11 Stocks with Positive Returns from August's Report

Exec Comp Aligned with ROIC		
Ticker	**Company Name**	**Change From 8/16/17**
PLCE	Childrens Place Inc.	14.7%
ABC	AmerisourceBergen Corp	5.3%
CULP	Culp Inc.	5.3%
SMP	Standard Motor Products	5.0%
ORLY	O'Reilly Automotive Inc.	3.2%
PLXS	Plexus Corporation	2.7%
GWW	W.W. Grainger	2.1%
ESRX	Express Scripts Inc.	2.0%
SBUX	Starbucks Corporation	1.5%
S&P 500	**S&P 500**	**1.2%**
NVR	NVR Inc.	1.2%
STX	Seagate Technology	0.9%

Sources: New Constructs, LLC
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

Exec Comp Aligned with ROIC: Methodology

Stocks on the Exec Comp Aligned with ROIC list must earn an Attractive or Very Attractive rating. Stocks earn an Attractive or Very Attractive rating when they have:

1. **High-Quality Earnings** based on:
    a. Returns on Invested Capital that are rising; and
    b. Economic Earnings/Cash Flows that are positive.

AND

2. **Cheap Valuations** based on:
    a. *Free-Cash Flow Yields*[1] that are positive;
    b. *Price-to-Economic Book Value* (EBV)[2] ratios that are relatively low; and
    c. *Growth Appreciation Periods*[3] (GAP) that are relatively low.

Figure 9 shows our Risk/Reward Rating analysis, which we apply to each of the 3000+ companies that we cover. Stocks get a grade of 1 to 5 for each criterion, 5 being the worst and 1 being the best score. The Overall score is based on the average score of all five criteria. Stocks must get an average score of 1.4 or below to be rated Very Attractive.

Figure 9: New Constructs Risk/Reward Rating for Stocks

	Quality of Earnings		Valuation		
Risk/Reward Rating	Econ vs Reported EPS	ROIC	FCF Yield	Price to EBV	GAP
Very Unattractive	Misleading Trend	Bottom Quintile	< -5%	> 3.5 or -1 < 0	> 50
Unattractive	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

Sources: New Constructs, LLC

Up to 15 stocks can make it into this model portfolio. These 15 stocks are broken into three groups of five:

1. Group 1: fairly accurate calculations of ROIC and strong alignment with executive compensation.
2. Group 2: question marks over their ROIC calculations but good alignment with executive compensation.
3. Group 3: weak alignment with executive compensation and put more value on metrics such as EPS.

[1] Free-Cash Flow Yields measure the % of the total value of the firm for which the Free Cash Flows of the firm account. The formula is FCF/Current Enterprise Value.
[2] Economic Book Value (EBV) measures the no-growth value of the business based on its annual after-tax cash flow. The Formula for EBV is: (NOPAT / WACC) + Excess Cash + Non-operating assets – Debt (incl. Operating Leases) - Value of Outstanding Stock Options – Minority Interests.
[3] Growth Appreciation Period measures the number of years, implied by the market-price, that a company will grow its economic earnings. This measure assigns a numerical value to the width of the moat around a firm's business.

Ultimately, any alignment between executive compensation and ROIC is better than none, but by using superior calculations and aligning a larger percentage of compensation with ROIC, the stocks in Group 1 do the best job of incentivizing shareholder value creation.

To be fair, calculating an accurate ROIC is not easy by any means. We have spent millions of dollars on technology to help us collect and model data as accurately as is humanly possible; so our standards are a little high. Still, we think investors should have high standards in this area.

For more on the methodology behind the Exec Comp Aligned with ROIC Model Portfolio, click here.

Explanation of Risk/Reward Rating System

Our Risk/Reward Rating System assigns a rating to every stock under our coverage according to what we believe are the 5 most important criteria for assessing the risk versus reward of stocks. See table that follows for details.

Risk/Reward Ranking	The Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.
Very Unattractive	FCF Yield is not included in the average.
Unattractive	FCF Yield is not included in the average.
Neutral	All criteria are equal-weighted in the average calculation.
Attractive	All criteria are equal-weighted in the average calculation.
Very Attractive	All criteria are equal-weighted in the average calculation.

Economic vs Reported EPS	Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.
Very Unattractive	Negative and declining Economic Earnings despite positive and rising Reported Earnings
Unattractive	Same as above except Reported Earnings are not rising or Reported Earnings are not positive
Neutral	Negative Economic and Reported Earnings
Attractive	Economic Earnings are positive
Very Attractive	Economic Earnings are positive and rising

Return on Invested Capital (ROIC)	Rates stocks based on their ROIC. Values based on Latest Fiscal Year.
Bottom Quintile	Very Unattractive = the bottom 20% of Russell 1000 companies
4th Quintile	Unattractive = the bottom 40% of Russell 1000 companies
3rd Quintile	Neutral = the middle 20% of Russell 1000 companies
2nd Quintile	Attractive = the top 40% of Russell 1000 companies
Top Quintile	Very Attractive = the top 20% of Russell 1000 companies

FCF Yield	Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.
<-5%	Very Unattractive = less than or equal to -5%
-5%<-1%	Unattractive = more than -5% but less than or equal to -1%
-1%<3%	Neutral = more than -1% but less than or equal to +3%
3%<10%	Attractive = more than +3% but less than or equal to +10%
>10%	Very Attractive = more than +10%

Price-to-EBV Ratio	Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.
>3.5 or -1>0	Very Unattractive = greater than or equal to 3.5 or less than 0 but greater than -1
2.4>3.5 or <-1	Unattractive = greater than or equal to 2.4 but less than 3.5 and less than or equal to -1
1.6>2.4	Neutral = greater than or equal to 1.6 but less than 2.4
1.1>1.6	Attractive = greater than or equal to 1.1 but less than 1.6
0>1.1	Very Attractive = greater than or equal to 0 but less than 1.1

Growth Appreciation Period (yrs)	Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.
>50	Very Unattractive = greater than or equal to 50 years
20>50	Unattractive = at least 20 years but less than 50
10>20	Neutral = at least 10 years but less than 20
3>10	Attractive = at least 3 years but less than 10
0>3	Very Attractive = at least 0 years but less than 3

Appendix A – Performance of Stocks on August's Report

Figure 10: Performance of All Stocks from August's Report

Exec Comp Aligned with ROIC		
Ticker	**Company Name**	**Change From 8/16/17**
PLCE	Childrens Place Inc.	14.7%
ABC	AmerisourceBergen Corp	5.3%
CULP	Culp Inc.	5.3%
SMP	Standard Motor Products	5.0%
ORLY	O'Reilly Automotive Inc.	3.2%
PLXS	Plexus Corporation	2.7%
GWW	W.W. Grainger	2.1%
ESRX	Express Scripts Inc.	2.0%
SBUX	Starbucks Corporation	1.5%
S&P 500	**S&P 500**	**1.2%**
NVR	NVR Inc.	1.2%
STX	Seagate Technology	0.9%
KMB	Kimberly-Clark Corp	-1.9%
CBRL	Cracker Barrel Old Country Store	-2.1%
HAS	Hasbro Inc.	-3.0%
IIIN	Insteel Industries	-4.8%
Portfolio Return		**2.1%**

Sources: New Constructs, LLC
Note: Gain/Decline performance analysis excludes transaction costs and dividends.

Appendix B – Additions and Deletions

Accurate ROIC Calculation/Strong Alignment with Exec Comp
Deletions:
CBRL - Expected to file 10-K within current month
CULP - Downgraded to Neutral: Lower Profitability

Additions:
JBSS - Addition by improved rank over other stocks
PEP - Addition by improved rank over other stocks

Flawed ROIC Calculation/Strong Alignment with Exec Comp
Deletions:
IIIN - Displaced by improved rank of other stocks

Additions:
KBAL - Addition by improved rank over other stocks

Weak Alignment with Exec Comp
Deletions:
PLXS - Displaced by improved rank of other stocks

Additions:
CLX - Addition by improved rank over other stocks

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