New Constructs®
Diligence | Independence | Performance

DILIGENCE PAYS 9/22/17

This white paper compares our data and ROIC for four global companies to other major research firms

Best-in-class data and analytics are the cornerstone of our value proposition to clients.

In a new white paper, "Getting ROIC right: how an accurate view of ROIC can drive improved shareholder value", we aim to demonstrate the superiority of our data, analytics and the importance of getting ROIC right.

Get the White Paper

Through detailed examples, this paper shows how our Robo-Analyst technology, accounting adjustments, and calculation of ROIC create a material difference in our fundamental research versus the industry. Appendices in the white paper show how other major firms' ROICs are way off target and lack the diligence we provide - for a mega cap company.

Real World Implications to Getting ROIC Right: Better Investments

Our diligent approach to calculating ROIC has practical, real-world implications for the investment decision making process. We've previously analyzed how optimizing ROIC could impact valuations, including case studies on Oracle (ORCL), American Express (AXP), and Morgan Stanley (MS). We argued that each of these firms were undervalued and that by aligning corporate strategy and incentive compensation with ROIC, each firm could substantially boost its market cap. Since then, each of these stocks have outperformed the S&P 500 and their valuations more closely align with what one would expect based on the firms' ROICs.

More recently, we highlighted how our forensic accounting and ROIC calculation empowers investors to identify alpha-generating investment ideas. In the article "Alpha-generating Forensic Accounting Examples", we identified five long ideas and three Danger Zone picks where our research deviated from traditional approaches. For example, NVIDIA Corporation (NVDA) was featured as a Long Idea in September 2015. Our research revealed that NVDA's true ROIC, as well as its rate of change, was significantly understated by GAAP-based ROIC. During the subsequent 237-day holding period, NVDA rose 86% compared to just 6% for the S&P 500.

How to Get ROIC Right

We've long argued that return on invested capital is not only the most intuitive measure of corporate performance, but it is also the best. However, the benefits of a focus on ROIC are only realized if that ROIC is accurate. Getting ROIC right, which requires adjustments for numerous accounting loopholes, is key to effectively measuring corporate performance. The paper provides empirical evidence that our diligent approach helps provide the best fundamental research.

At the same time, we want investors to know just how much work goes into getting ROIC right. The required diligence shouldn't be hidden inside a "black-box." As Ernst & Young notes, "The other advantage of New Constructs is the transparency in disclosing calculations and all the data behind them. It is hard to determine the calculations at a granular level from the reports of many data providers."

To that end, we're 100% transparent about the adjustments and calculations we make in regards to after-tax profit (NOPAT), invested capital, ROIC, and other metrics such as free cash flow and economic earnings.

Click here to learn how we calculate ROIC.

For more information, see below for insights into the importance of getting ROIC right.

1. If ROIC is So Great, They Why Doesn't Everyone Use It?
2. ROIC: The Paradigm for Linking Corporate Performance to Valuation
3. Make ROIC Great Again

4. Bad ROIC Drives Bad Valuation
5. Case Studies on Importance of ROIC

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

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New Constructs® - Research to Fulfill the Fiduciary Duty of Care

Ratings & screeners on 3000 stocks, 450 ETFs and 7000 mutual funds help you make prudent investment decisions.

New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
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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