



## Featured Stocks in October's Exec Comp & ROIC Model Portfolio

One new stock made October's Exec Comp Aligned with ROIC Model Portfolio, available to members as of October 13, 2017.

### Recap from September's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (+0.8%) underperformed the S&P 500 (2.2%) last month. The best performing stock in the portfolio was Kimball International (KBAL), which was up 16%. Overall, four out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P and seven had positive returns in September.

Since inception, this model portfolio is up 20% while the S&P 500 is up 22%.

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.

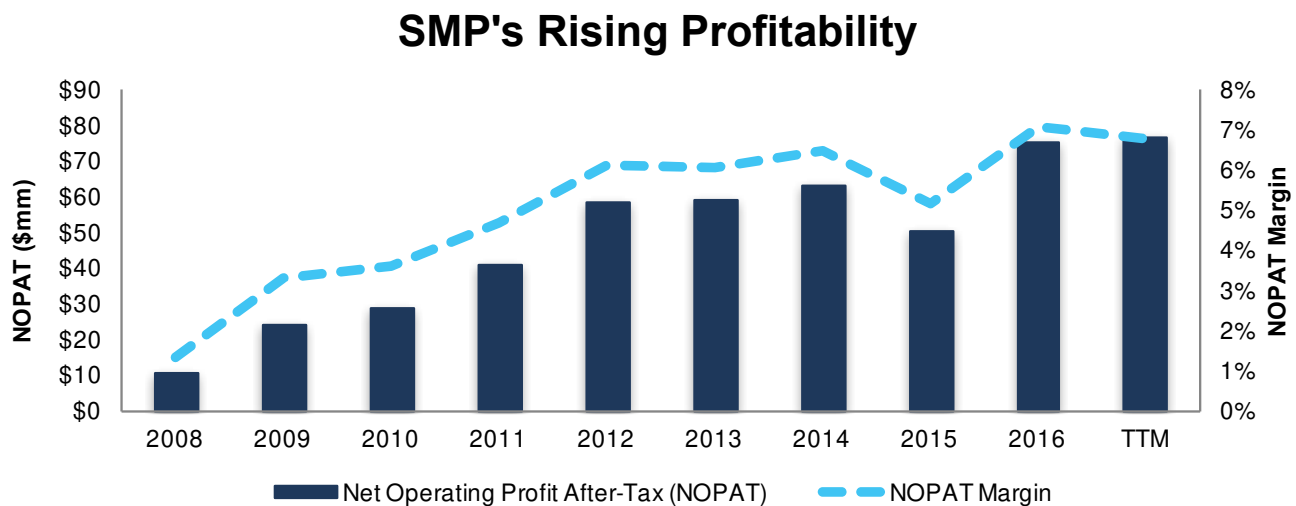
This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the [primary driver of shareholder value creation](#).<sup>1</sup>

### New Stock Feature for October: Standard Motor Products (SMP: \$47/share)

Standard Motor Products (SMP), a manufacturer of aftermarket engine management and temperature control automotive parts, is one of the stocks in October's Exec Comp Aligned with ROIC Model Portfolio. SMP was also a featured [Long Idea in May 2017](#). SMP is also in the most recent [Most Attractive Stocks](#) and [Dividend Growth Stocks](#) Model Portfolios.

Since 2008, SMP's revenue has grown 4% compounded annually while after-tax profit (NOPAT) has grown an impressive 28% compounded annually. This accelerated NOPAT growth is attributable to improving profit margins. Per Figure 1, the firm's NOPAT margin has increased from 1% in 2008 to 7% over the trailing twelve months (TTM). Longer-term, SMP has grown revenue 3% compounded annually and NOPAT 4% compounded annually since 1998.

Figure 1: SMP's NOPAT and Margin Since 2008



Sources: New Constructs, LLC and company filings

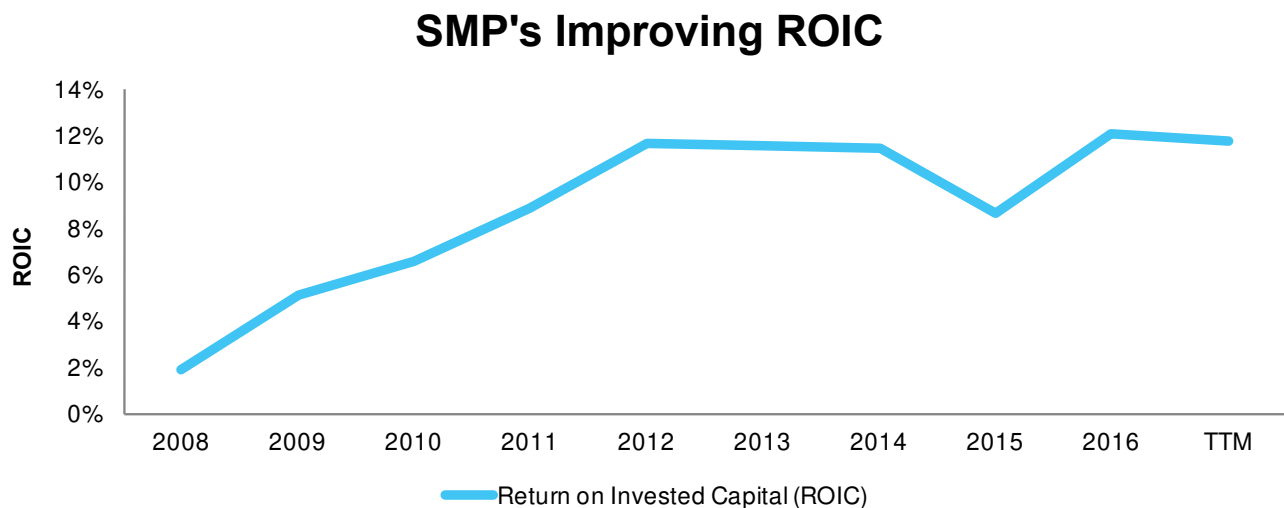
<sup>1</sup> Ernst & Young's recent white paper, "[Getting ROIC Right](#)", proves the superiority of our research and analytics.

### Executive Compensation Plan is Directly Aligned with Creating Shareholder Value

70% of SMP executives' annual cash incentives are tied to [improvements in Economic Value Added](#) (EVA), also known as [economic earnings](#). EVA has been a target metric in Standard Motor's executive compensation plan since 1998. SMP's compensation committee uses EVA because "the principles of an EVA program have a better statistical correlation with the creation of value for stockholders than a cash incentive program based on performance measures."

The focus on EVA helps ensure executives continue to be good stewards of capital and as SMP states, "EVA recognizes the productive use of capital assets and, therefore, wise, responsible decision-making regarding capital investments." Per Figure 2, SMP's ROIC has improved from 2% in 2008 to 12% TTM. In addition, SMP has grown economic earnings from -\$12 million in 2008 to \$39 million TTM.

**Figure 2: SMP's ROIC Since 2008**



Sources: New Constructs, LLC and company filings

### SMP's Low Valuation Provides Quality Risk/Reward

At its current price of \$47/share, SMP has a price-to-economic book value ([PEBV](#)) ratio of 0.9. This ratio means the market expects SMP's NOPAT to permanently decline by 10%. This expectation seems rather pessimistic given the impressive NOPAT growth achieved since 2008 and the 4% compound annual growth achieved over nearly two decades.

If SMP can maintain TTM NOPAT margins (7%) and [grow NOPAT by 4% compounded annually for the next decade](#), the stock is worth \$60/share today – a 27% upside.

### Auditable Impact of Footnotes and Forensic Accounting Adjustments<sup>2</sup>

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 Standard Motor Product's 2016 10-K:

**Income Statement:** we made \$27 million of adjustments, with a net effect of removing \$15 million in non-operating expense (1% of revenue). We removed \$6 million in [non-operating income](#) and \$21 million in [non-operating expenses](#). You can see all the adjustments made to SMP's income statement [here](#).

**Balance Sheet:** we made \$314 million of adjustments to calculate invested capital with a net increase of \$139 million. The largest adjustment was \$70 million due to [asset write-downs](#). This adjustment represented 14% of reported net assets. You can see all the adjustments made to SMP's balance sheet [here](#).

<sup>2</sup> Ernst & Young's recent white paper, "[Getting ROIC Right](#)", proves the superiority of our research and analytics.



Valuation: we made \$110 million of adjustments with a net effect of decreasing shareholder value by \$110 million. There were no adjustments that increased shareholder value. The largest adjustment was \$109 million in [total debt](#), which includes \$30 million in [off-balance sheet operating leases](#). This lease adjustment represents 3% of SMP's market cap. Despite the net decrease in shareholder value, SMP 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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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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