



Model Portfolio: April 2018: Exec Comp Aligned with ROIC

15 Large/Mid/Small Cap Stocks

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- **Figure 1 shows three new stocks that make our April list.**
- **The Executive Compensation Aligned with ROIC Portfolio (-0.4%) outperformed the S&P 500 (-4.1%) last month.**
- **Since inception, this model portfolio is up 26% while the S&P 500 is up 23%.**
- **Figure 8 shows the 13 stocks that outperformed from March'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.**
- **Ernst & Young's recent white paper, "[Getting ROIC Right](#)", proves the superiority of our research and analytics.**
- **Our Robo-Analyst technology, [featured by Harvard Business School](#), analyzes thousands of stocks to help pick the best.**

Figure 1: Additions for April

Portfolio Additions	
Ticker	Company Name
HD	The Home Depot Inc.
NLS	Nautilus Group
PLCE	Childrens Place 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 April

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

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

			High-Quality Earnings		Cheap Valuation				Executive Compensation Plans Aligned with ROIC
			As of Last Twelve Months		as of 4/11/18				
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 Cyclicals	\$127.96	27%	4%	1.1	Less than 1	\$11,381	NVR Proxy Statement
LEA	Lear Corp	Consumer Cyclicals	\$12.90	20%	4%	0.8	Less than 1	\$13,045	LEA Proxy Statement
KMB	Kimberly-Clark Corp	Consumer Non-cyclicals	\$4.98	15%	6%	0.9	Less than 1	\$37,803	KMB Proxy Statement
CBRL	Cracker Barrel	Consumer Cyclicals	\$6.26	14%	4%	1.0	Less than 1	\$3,910	CBRL Proxy Statement
JBSS	John B. Sanfilippo & Son	Consumer Non-cyclicals	\$1.68	11%	1%	1.1	3	\$662	JBSS Proxy Statement

* Addition to the list in April

Stocks are ranked by ROIC in Descending Order

Sources: New Constructs, LLC

The 5 “Flawed ROIC Calculation/Strong Alignment with Exec Comp” Stocks for April

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

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

			High-Quality Earnings		Cheap Valuation				Executive Compensation Plans Aligned with ROIC
			As of Last Twelve Months		as of 4/11/18				
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 Cyclicals	\$3.46	17%	5%	1.0	Less than 1	\$10,844	HAS Proxy Statement
LUV	Southwest Airlines	Industrials	\$2.49	15%	8%	0.9	Less than 1	\$31,455	LUV Proxy Statement
PLCE*	Childrens Place Inc.	Consumer Cyclicals	\$5.54	14%	7%	0.9	Less than 1	\$2,337	PLCE Proxy Statement
GWW	W.W. Grainger, Inc.	Industrials	\$7.51	13%	5%	1.5	Less than 1	\$15,663	GWW Proxy Statement
HURC	Hurco Companies, Inc.	Industrials	\$0.96	11%	10%	1.0	Less than 1	\$308	HURC Proxy Statement

* Addition to the list in April

Stocks are ranked by ROIC in Descending Order

Sources: New Constructs, LLC

The 5 “Weak Alignment with Exec Comp” Stocks for April

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

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

			High-Quality Earnings		Cheap Valuation				Executive Compensation Plans Aligned with ROIC
			As of Last Twelve Months		as of 4/11/18				
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
HD*	The Home Depot	Consumer Cyclicals	\$6.29	25%	4%	1.5	2	\$200,046	HD Proxy Statement
CL	Colgate-Palmolive	Consumer Non-cyclicals	\$2.37	20%	4%	1.4	1	\$62,481	CL Proxy Statement
PCAR	PACCAR Inc.	Industrials	\$1.77	15%	3%	1.3	Less than 1	\$23,594	PCAR Proxy Statement
PLXS	Plexus Corporation	Technology	\$1.40	11%	4%	1.1	2	\$2,037	PLXS Proxy Statement
NLS*	Nautilus Group	Consumer Non-cyclicals	\$0.37	11%	10%	1.0	Less than 1	\$414	NLS Proxy Statement

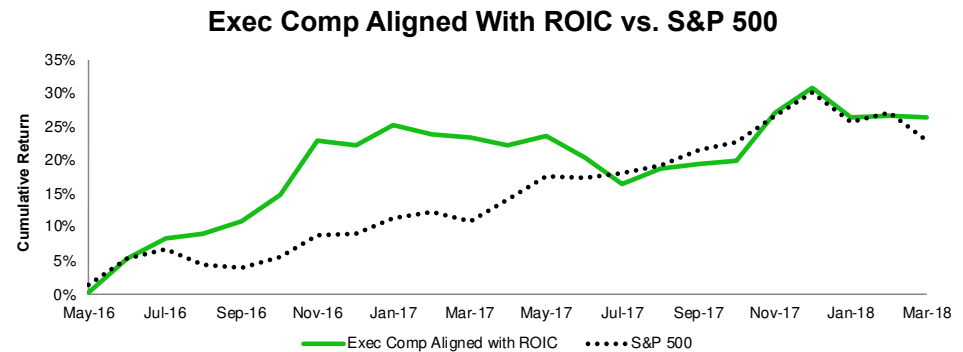
* Addition to the list in April

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 outperformed since inception in May 2016. Since then, the Exec Comp Aligned with ROIC Portfolio has cumulative returns of 26% compared to 23% 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/Dcline performance analysis excludes transaction costs and dividends.

Figure 6: Monthly Return of Exec Comp Aligned with ROIC

	Portfolio Returns							
	2016	1Q17	2Q17	3Q17	4Q17	18-Jan	18-Feb	18-Mar
Exec Comp Aligned With ROIC	22.3%	1.1%	-2.9%	-1.0%	11.4%	-4.5%	0.4%	-0.4%
S&P 500	9.0%	2.0%	6.4%	4.1%	8.7%	-4.4%	1.2%	-4.1%

Sources: New Constructs, LLC

Note: Gain/Dcline performance analysis excludes transaction costs and dividends.

Figure 7: Cumulative Return of Exec Comp Aligned with ROIC

	Cumulative Portfolio Returns							
	2016	1Q17	2Q17	3Q17	4Q17	18-Jan	18-Feb	18-Mar
Exec Comp Aligned With ROIC	22%	23%	21%	20%	31%	26%	27%	26%
S&P 500	9%	11%	17%	22%	30%	26%	27%	23%

Sources: New Constructs, LLC

Note: Gain/Dcline performance analysis excludes transaction costs and dividends.



Exec Comp Aligned with ROIC: Monthly Updates

The [Exec Comp Aligned With ROIC Portfolio](#) (-0.4%) outperformed the S&P 500 (-4.1%) last month. 13 stocks from our March Exec Comp Aligned with ROIC lists outperformed the S&P 500, and seven 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 March performance based on closing prices from March 15, 2018 to April 11, 2018. We published last month's report to subscribers on March 15, 2018.

Figure 8: 13 Stocks That Outperformed from March's Report

Exec Comp Aligned With ROIC		
Ticker	Company Name	Change From 3/15/18
HUM	Humana Inc.	4.1%
LEA	Lear Corp	3.0%
CL	Colgate-Palmolive Company	2.6%
NVR	NVR Inc.	2.1%
CBRL	Cracker Barrel Old Country Store	1.9%
SYU	SYSCO Corporation	1.9%
PCAR	PACCAR Inc.	0.3%
JBSS	John B. Sanfilippo & Son	0.0%
HURC	Hurco Companies, Inc.	-0.1%
EBF	Ennis Inc.	-0.7%
GWW	W.W. Grainger, Inc.	-0.8%
HAS	Hasbro Inc.	-0.9%
KMB	Kimberly-Clark Corp	-2.8%
S&P 500	S&P 500	-4.1%

Sources: New Constructs, LLC

Note: Gain/Dcline 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:

- Returns on Invested Capital that are rising; and
- Economic Earnings/Cash Flows that are positive.

AND

2. **Cheap Valuations** based on:

- Free-Cash Flow Yields¹ that are positive;
- Price-to-Economic Book Value (EBV)² ratios that are relatively low; and
- Growth Appreciation Periods³ (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

Risk/Reward Rating ⑦	Quality of Earnings		Valuation		
	Econ vs Reported EPS ②	ROIC ①	FCF Yield ③	Price to EBV ④	GAP ⑤
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:

- Group 1: fairly accurate calculations of ROIC and strong alignment with executive compensation.
- Group 2: question marks over their ROIC calculations but good alignment with executive compensation.
- 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](#).



Appendix A – Performance of Stocks on March's Report

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

Exec Comp Aligned With ROIC		
Ticker	Company Name	Change From 3/15/18
HUM	Humana Inc.	4.1%
LEA	Lear Corp	3.0%
CL	Colgate-Palmolive Company	2.6%
NVR	NVR Inc.	2.1%
CBRL	Cracker Barrel Old Country Store	1.9%
SYT	SYSCO Corporation	1.9%
PCAR	PACCAR Inc.	0.3%
JBSS	John B. Sanfilippo & Son	0.0%
HURC	Hurco Companies, Inc.	-0.1%
EBF	Ennis Inc.	-0.7%
GWW	W.W. Grainger, Inc.	-0.8%
HAS	Hasbro Inc.	-0.9%
KMB	Kimberly-Clark Corp	-2.8%
S&P 500	S&P 500	-4.1%
PLXS	Plexus Corporation	-6.0%
LUV	Southwest Airlines Company	-10.7%
Portfolio Return		-0.4%

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:

None

Additions:

None

Flawed ROIC Calculation/Strong Alignment with Exec Comp

Deletions:

HUM - Displaced by improved rank of other stocks

Additions:

PLCE - Addition by improved rank over other stocks

Weak Alignment with Exec Comp

Deletions:

EBF - Expected to file 10-K within current month

SYN - Downgraded to Neutral

Additions:

HD - Addition by improved rank over other stocks

NLS - Addition by improved rank over other stocks



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 = < 4.8%
4th Quintile	Unattractive = 4.8% < 7.5%
3rd Quintile	Neutral = 7.5% < 10.5%
2nd Quintile	Attractive = 10.5% < 14.5%
Top Quintile	Very Attractive = > 14.5%

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



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