Featured Stock in November's Exec Comp & ROIC Model Portfolio

Four new stocks make November's Exec Comp Aligned with ROIC Model Portfolio, available to members as of November 15, 2018.

Recap from October's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (-0.2%) outperformed the S&P 500 (-3.1%) as a long portfolio last month. The best performing stock in the portfolio was up 7%. Overall, 10 out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P in October.

Since inception, this model portfolio is up 23% while the S&P 500 is up 22%.

The success of this Model Portfolio highlights the value of our Robo-Analyst technology,[1] which scales our forensic accounting expertise (featured in Barron's) across thousands of stocks.

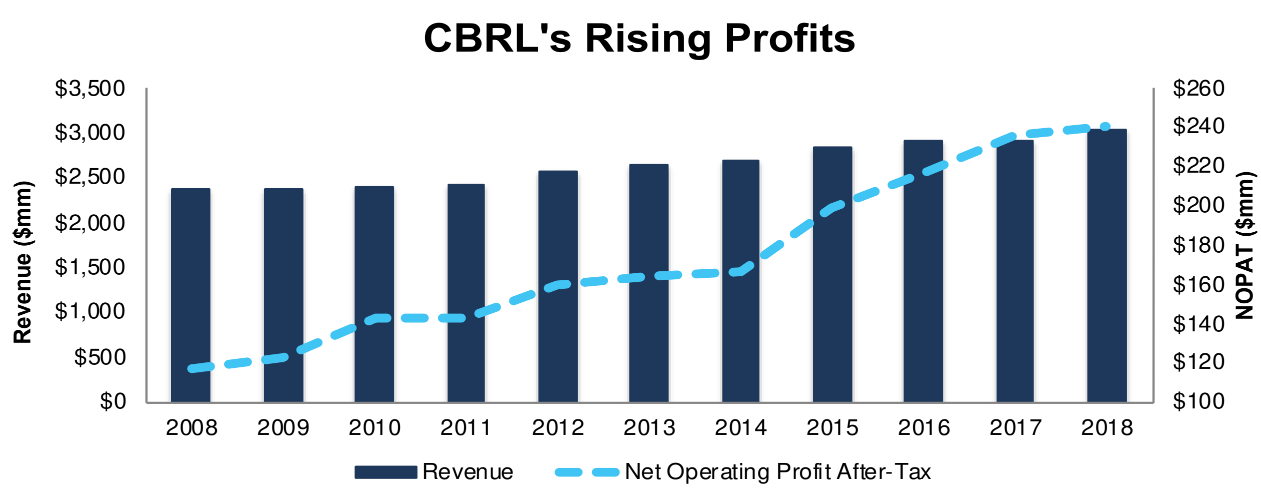
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the primary driver of shareholder value creation.[2]

New Stock Feature for November: Cracker Barrel Old Country Store (CBRL: $175/share)

Cracker Barrel (CBRL) is the featured stock in November's Exec Comp Aligned with ROIC Model Portfolio. We previously featured CBRL as a Long Idea in March 2017. We closed the position in June 2018, perhaps too soon. Over the last five months, fundamentals have improved faster than the stock price appreciated, which led to an upgrade of the stock to Very Attractive in October.

Over the past decade, CBRL has grown after-tax profit (NOPAT) by 7% compounded annually. Over the same time, CBRL has improved its NOPAT margin from 5% in 2008 to 8% in 2018.

Figure 1: CBRL's Revenue & NOPAT Since 2008



Sources: New Constructs, LLC and company filings

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] Ernst & Young's recent white paper, "Getting ROIC Right", proves the superiority of our research and analytics.

Executive Compensation Plan Helps Drive Shareholder Value Creation

CBRL has included ROIC as a performance metric in its executive compensation plan since 2011. Last year, 50% of CBRL's long-term performance incentive program was tied to the achievement of a target ROIC.

The focus on return on invested capital helps ensure executives' interests are aligned with shareholders' interests. Since adding ROIC to its compensation plan in 2011, CBRL has improved ROIC from 9% to 15%. CBRL's executive compensation plan lowers the risk of investing in the company's stock because we know executives' interests are tied to shareholders' interests.

CBRL Provides Significant Upside Potential

At its current price of $175/share, CBRL has a price-to-economic book value (PEBV) ratio of 1.1. This ratio means the market expects CBRL's NOPAT to grow by no more than 10% from current levels. This expectation seems pessimistic for a firm that has grown NOPAT by 8% compounded annually over the past five years and 7% compounded annually over the past decade.

If CBRL can maintain TTM NOPAT margins (8%) and grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $210/share today – a 20% upside. See the math behind this dynamic DCF scenario.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments we make based on Robo-Analyst findings in Cracker Barrel's 2018 10-K:

Income Statement: we made $97 million of adjustments, with a net effect of removing $7 million in non-operating income (1% of revenue). You can see all the adjustments made to CBRL's income statement here.

Balance Sheet: we made $584 million of adjustments to calculate invested capital with a net increase of $482 million. One of the largest adjustments was $451 million due to operating leases. This adjustment represented 39% of reported net assets. You can see all the adjustments made to CBRL's balance sheet here.

Valuation: we made $903 million of adjustments with a net effect of decreasing shareholder value by $903 million. There were no adjustments that increased shareholder value. Apart from total debt, which includes the operating leases noted above, one of the largest adjustments to shareholder value was $52 million in deferred tax liabilities. This adjustment represents 1% of CBRL's market cap. Despite the net decrease in shareholder value, CBRL remains undervalued.

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Disclosure: David Trainer and Kyle Guske II 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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