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

Four new stocks make January's Exec Comp Aligned with ROIC Model Portfolio, available to members as of January 15, 2019

Recap from December's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (+1.5%) outperformed the S&P 500 (-0.7%) last month. The best performing stock in the portfolio was up 19.7%. Overall, 8 out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P in December.

Since inception, this model portfolio is up 20% while the S&P 500 is up 19%.

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.

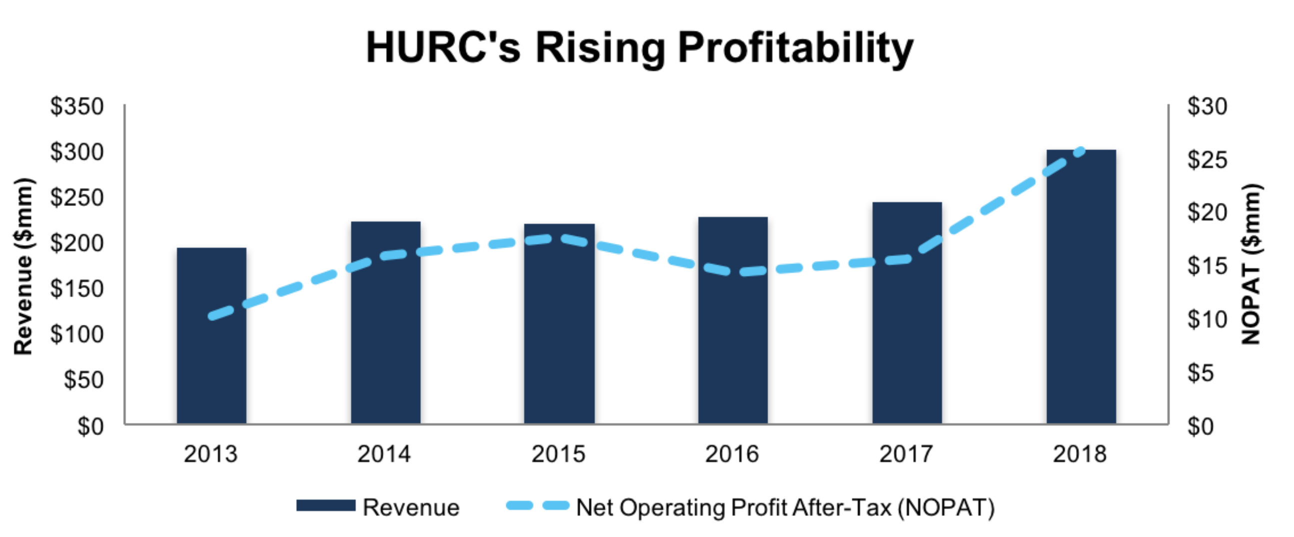
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the primary driver of shareholder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

New Stock Feature for January: Hurco Companies (HURC: $37/share)

Hurco Companies (HURC) is the featured stock in January's Exec Comp Aligned with ROIC Model Portfolio.

Since 2013, HURC has grown revenue by 9% compounded annually and after-tax profit (NOPAT) by 20% compounded annually to $26 million in fiscal year 2018. HURC has managed this profit growth by increasing its NOPAT margin from 5% in 2013 to 9% in 2018. Further highlighting the strength of its business, HURC has generated cumulative free cash flow (FCF) of $33 million (12% of market cap) over the past five years.

Figure 1: HURC's Revenue & NOPAT Since 2013



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" demonstrates the superiority of our stock research and analytics.

Executive Compensation Plan Helps Drive Shareholder Value Creation

ROIC was added to Hurco's executive compensation plan in 2014 as a target goal for performance-based equity awards. In 2018, 35% of performance-based equity awards were tied to the firm's three-year average ROIC. This focus on ROIC has led to Hurco's ROIC improving from 8% in 2013 (year before ROIC was added) to 14% in 2018. Hurco's exec comp plan lowers the risk of investing in the company's stock because we know executives are held accountable for creating real profits.

Low Valuation Provides Upside Potential

At its current price of $37/share, HURC has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means the market expects HURC's NOPAT to permanently decrease by 30%. This expectation seems rather pessimistic given Hurco has grown NOPAT 8% compounded annually since 1998 and 20% compounded annually since 2013.

If HURC can maintain 2018 pre-tax margins (9%) and grow NOPAT by 4% compounded annually for the next decade, the stock is worth $63/share today – a 70% upside. See the math behind this dynamic DCF scenario.

Impacts of Footnotes Adjustments and Forensic Accounting

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 Hurco's 2018 10-K:

Income Statement: we made $6 million of adjustments, with a net effect of removing $4 million in non-operating expense (1% of revenue). You can see all the adjustments made to HURC's income statement here.

Balance Sheet: we made $106 million of adjustments to calculate invested capital with a net decrease of $46 million. One of the largest adjustments was $11 million due to adjustments for other comprehensive income. This adjustment represented 5% of reported net assets. You can see all the adjustments made to HURC's balance sheet here.

Valuation: we made $75 million of adjustments with a net effect of increasing shareholder value by $53 million. The largest adjustment to shareholder value was $62 million in excess cash. This adjustment represents 4% of HURC's market cap.

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

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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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