Featured Stocks in February's Exec Comp & ROIC Model Portfolio

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

Recap from January's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (-4.5%) underperformed the S&P 500 (-4.4%) last month. The best performing stock in the portfolio was W.W. Grainger Inc. (GWW), which was up 15%. Overall, six out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P in January.

Since inception, this model portfolio is up 26% while the S&P 500 is up 26% as well.

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.

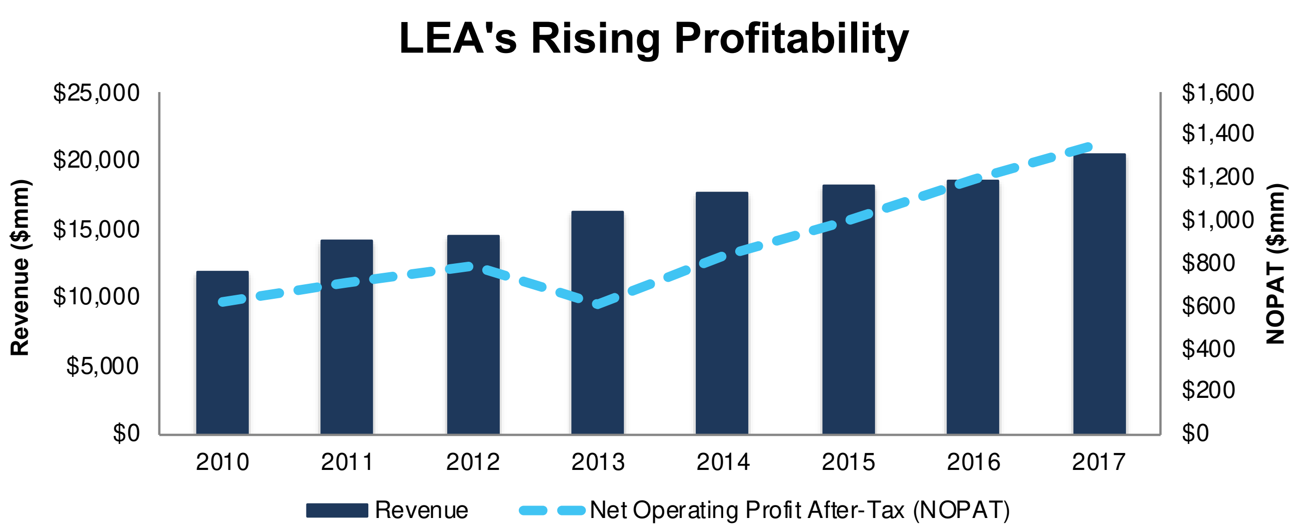
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the primary driver of shareholder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

New Stock Feature for February: Lear Corp (LEA: $190/share)

Lear Corp, an automotive seating and electrical systems manufacturer, is the featured stock in February's Exec Comp Aligned with ROIC Model Portfolio. We originally featured Lear Corp as a Long Idea in July 2016 and after rising 54%, we reiterated our Long Idea in October 2017. LEA is now up 66% since the original Long Idea while the S&P 500 is up 25%. Despite its outperformance, LEA remains undervalued.

Since 2010, LEA has grown revenue by 8% compounded annually and after-tax profit (NOPAT) by 12% compounded annually, per Figure 1. NOPAT margin improved from 5% in 2010 to 7% in 2017. Further highlighting the strength of its business, LEA has generated cumulative free cash flow (FCF) of $2.1 billion (16% of market cap) over the past five years.

Figure 1: LEA Revenue and NOPAT Growth Since 2010



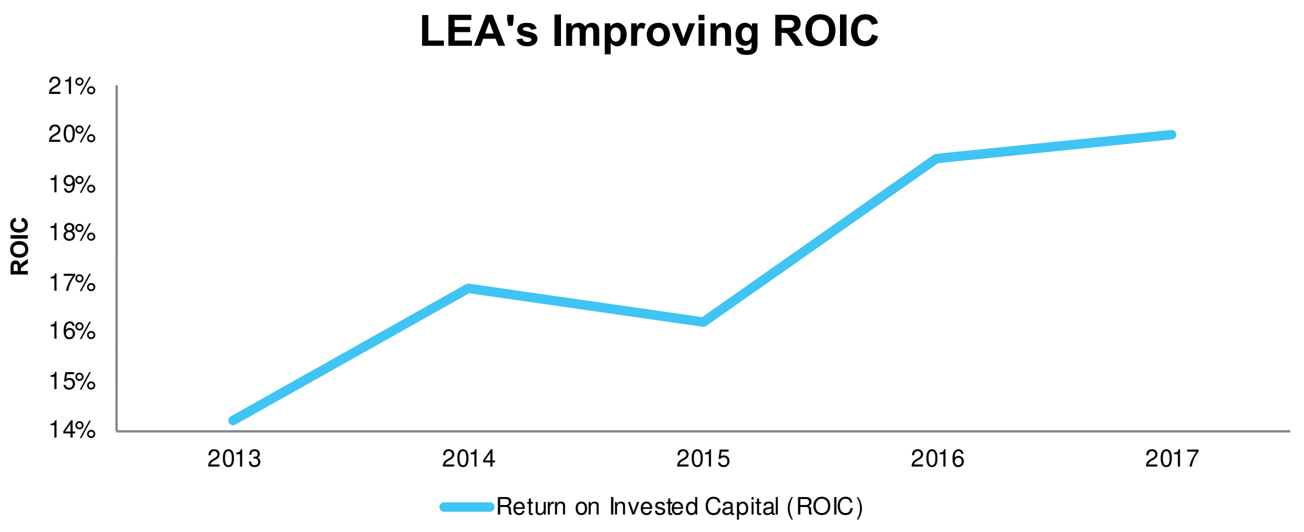
Sources: New Constructs, LLC and company filings

[1] 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

Lear Corp's executive compensation plan recognizes the importance of ROIC. Two-thirds of long-term incentive awards are directly tied to achieving a target ROIC. Long-term awards make up 53% of CEO pay and 44% of other executives' pay. This focus on ROIC has led to Lear's ROIC improving from 14% in 2013 to a top-quintile 20% in 2017, per Figure 2. Lear'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.

Figure 2: Lear Corp's ROIC Since 2013



Sources: New Constructs, LLC and company filings

LEA's Valuation Provides Quality Upside Potential

At its current price of $190/share, LEA has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects LEA's NOPAT to permanently decline by 20%. This expectation seems rather pessimistic given a rising auto industry and LEA's track record of NOPAT growth since 2010.

If LEA can maintain 2017 NOPAT margins (7%) and grow NOPAT by 4% compounded annually for the next decade, the stock is worth $268/share today – a 41% upside.

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 Lear Corp's 2017 10-K:

Income Statement: we made $758 million of adjustments, with a net effect of removing $74 million in non-operating expense (<1% of revenue). We removed $342 million in non-operating income and $416 million in non-operating expenses. You can see all the adjustments made to LEA's income statement here.

Balance Sheet: we made $2.7 billion of adjustments to calculate invested capital with a net decrease of $280 million. One of the largest adjustments was $647 million due to deferred tax assets. This adjustment represented 9% of reported net assets. You can see all the adjustments made to LEA's balance sheet here.

Valuation: we made $3.6 billion of adjustments with a net effect of decreasing shareholder value by $2.5 billion. The largest adjustment to shareholder value was $2.5 billion in total debt, which includes $451 million in operating leases. This lease adjustment represents 4% of LEA's market cap. Despite the net decrease in shareholder value, LEA 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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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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