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

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

**Recap from February's Picks**

Our Exec Comp Aligned with ROIC Model Portfolio (+0.4%) underperformed the S&P 500 (+1.2%) last month. The best performing stock in the portfolio was Seagate (STX), which was up 16%. Overall, six out of the 15 Exec Comp Aligned with ROIC stocks outperformed the S&P in February.

Since inception, this model portfolio is up 27% while the S&P 500 is up 27% as well.

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.

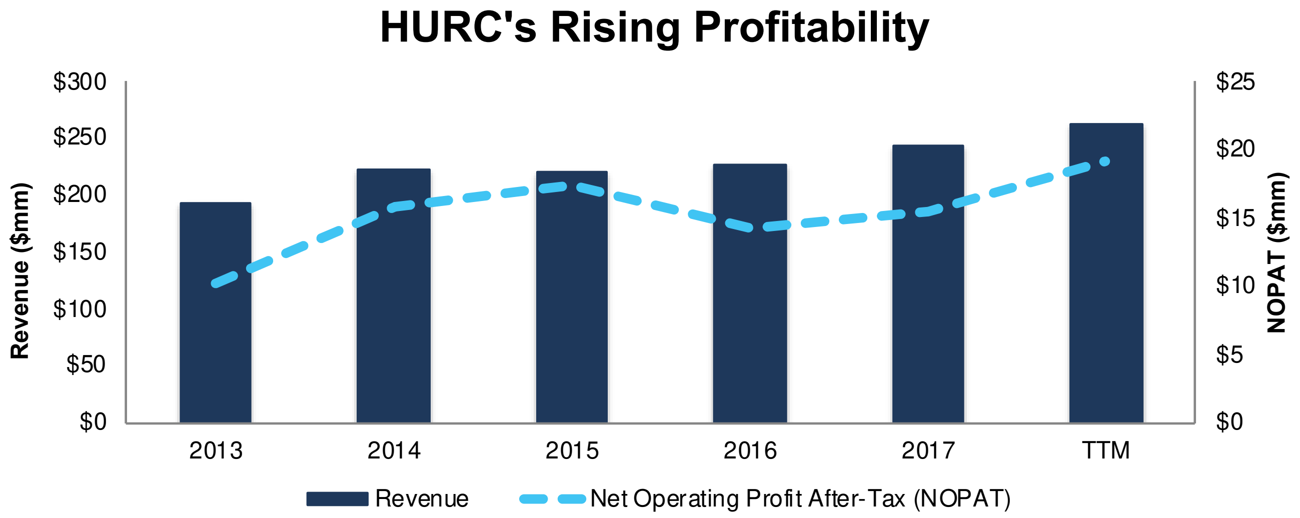
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the primary driver of shareholder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

**New Stock Feature for March: Hurco Companies (HURC: $47/share)**

Hurco Companies (HURC), a computerized machine tools manufacturer, is the featured stock in March's Exec Comp Aligned with ROIC Model Portfolio. We briefly featured HURC in April 2015 and the stock is up 43% since while the S&P is up just 29%. Despite the outperformance, HURC remains undervalued.

Since 2013, HURC has grown revenue by 6% compounded annually and after-tax profit (NOPAT) by 11% compounded annually to $15 million in fiscal year 2017. NOPAT has increased to $19 million over the last twelve months.

**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", proves the superiority of our research and analytics.

HURC has managed this profit growth by increasing its NOPAT from 5% in 2013 to 7% TTM. Further highlighting the strength of its business, HURC has generated cumulative free cash flow (FCF) of $33 million (10% of market cap) over the past five years.

**Executive Compensation Plan Helps Drive Shareholder Value Creation**

Return on invested capital (ROIC) was added to Hurco Companies' executive compensation plan in 2014 as a target goal for performance-based equity awards. In 2017, 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 11% over the last twelve months. 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 $47/share, HURC has a price-to-economic book value (PEBV) ratio of 1.0. This ratio means the market expects HURC's NOPAT to never meaningfully grow from its current levels. This expectation seems rather pessimistic given Hurco has grown NOPAT by 6% compounded annually since 1998 and 11% compounded annually since 2013.

If HURC can maintain TTM margins (7%) and grow NOPAT by 7% compounded annually for the next decade, the stock is worth $58/share today – a 23% 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 Hurco's 2017 10-K:

Income Statement: we made $2 million of adjustments, with a net effect of removing less than $1 million in non-operating expense (<1% of revenue). We removed $1 million in non-operating income and $1 million in non-operating expenses. You can see all the adjustments made to HURC's income statement here.

Balance Sheet: we made $92 million of adjustments to calculate invested capital with a net decrease of $32 million. One of the largest adjustments was $8 million due to asset write-downs. This adjustment represented 4% of reported net assets. You can see all the adjustments made to HURC's balance sheet here.

Valuation: we made $ 79 million of adjustments with a net effect of increasing shareholder value by $58 million. Apart from $9 million in total debt, which includes $7 million in operating leases, the largest adjustment to shareholder value was $67 million in excess cash. This adjustment represents 21% of HURC's market cap.

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*Disclosure: David Trainer, Kyle Guske II and Sam McBride 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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