



## Featured Stock in October's Exec Comp & ROIC Model Portfolio

Four new stocks make October's Exec Comp Aligned with ROIC Model Portfolio, available to members as of October 16, 2019.

### Recap from September's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (-1.3%) outperformed the S&P 500 (-1.7%) from September 13, 2019 through October 14, 2019. The best performing stock in the portfolio was up 8%. Overall, eight out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P from September 13, 2019 through October 14, 2019.

Get the best fundamental research

Only our research utilizes the superior data and earnings adjustments featured by the Harvard Business School and MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)." The success of this Model Portfolio highlights the value of our [Robo-Analyst technology](#)<sup>1</sup>, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.

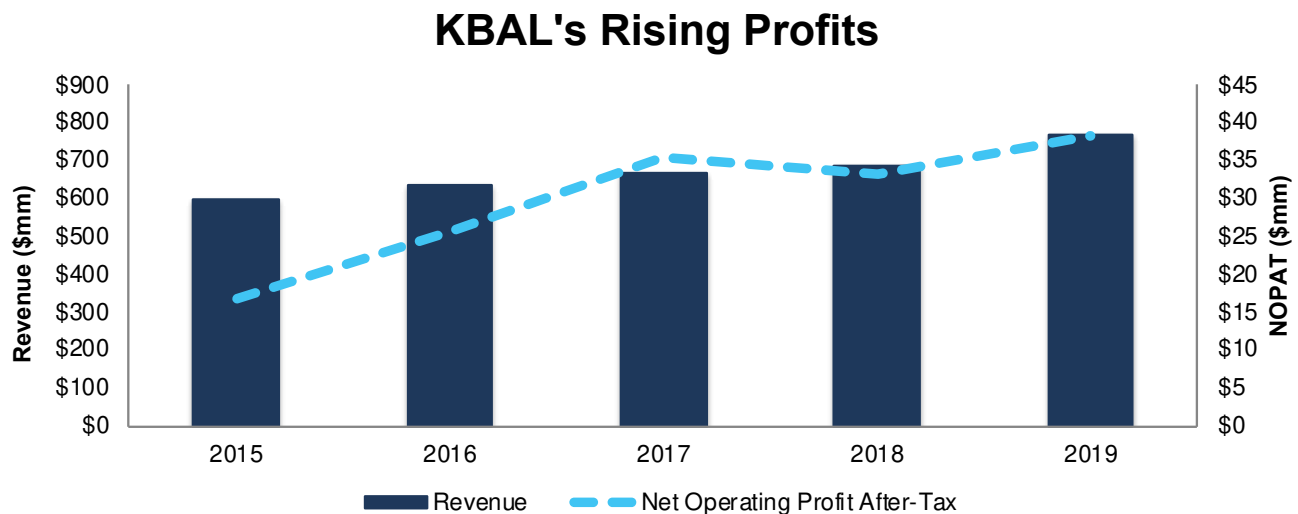
This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating and align executive compensation with improving ROIC. We think this combination provides a uniquely well-screened list of long ideas because return on invested capital (ROIC) is the [primary driver of shareholder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

### New Stock Feature for October: Kimball International (KBAL: \$21/share)

Kimball International (KBAL) is the featured stock in October's Exec Comp Aligned with ROIC Model Portfolio.

Since fiscal 2015, KBAL has grown revenue by 6% compounded annually and after-tax operating profit (NOPAT) by 22% compounded annually. Profit growing faster than revenue is a direct result of KBAL's NOPAT margin increasing from 3% in 2015 to 5% in fiscal 2019.

Figure 1: KBAL's Revenue & NOPAT Since 2015



Sources: New Constructs, LLC and company filings

<sup>1</sup> Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

<sup>2</sup> This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.



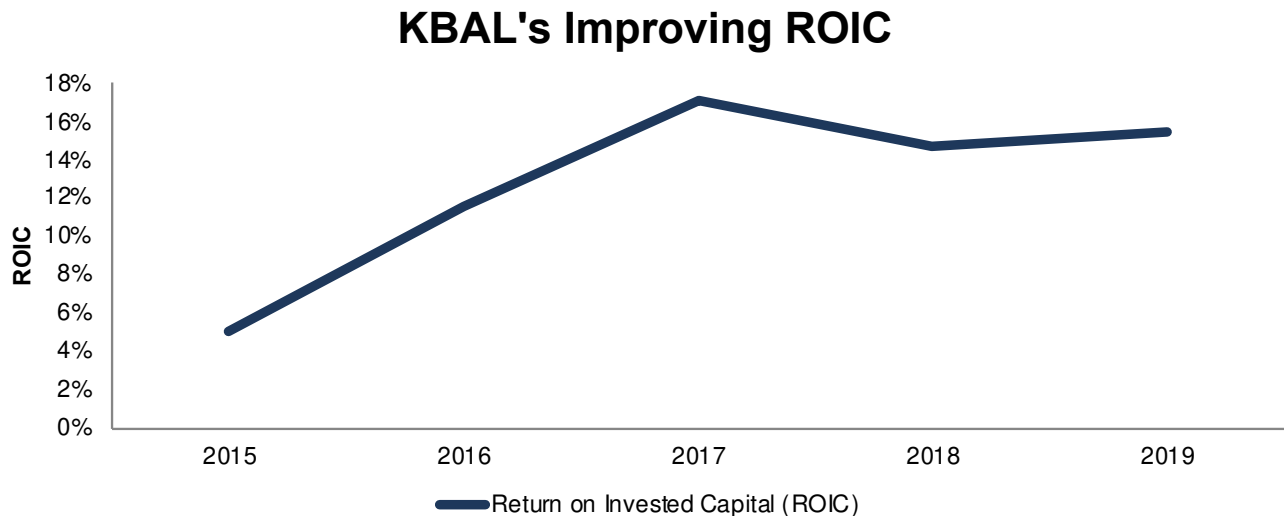
### Executive Compensation Plan Helps Drive Shareholder Value Creation

With the exception of fiscal 2018, KBAL has include some form of economic profit, return on capital, or return on invested capital in its executive compensation plan in each year since 1996. In fiscal 2018, the Compensation Committee replaced return on capital with return on equity when determining performance shares. However, this shift was short-lived, and after just one year (in which its ROIC fell), return on capital was added back to the exec comp plan.

In fiscal 2019, annual performance shares were earned based on achieving a target annual return on capital goal. For fiscal 2020, the annual performance share target will be based on annual return on invested capital. The Compensation Committee made this change “because it [ROIC] is a more common metric utilized by investors to measure performance relative to the capital invested in a business.”

Per Figure 2, KBAL has improved its ROIC from 5% in fiscal 2015 to 15% in fiscal 2019. KBAL’s executive compensation plan lowers the risk of investing in this stock because we know executives’ interests are tied to shareholders’ interests.

**Figure 2: KBAL’s ROIC Since 2015**



Sources: New Constructs, LLC and company filings

### KBAL Is Undervalued

At its current price of \$21/share, KBAL has a price-to-economic book value ([PEBV](#)) ratio of 1.1. This ratio means the market expects KBAL’s NOPAT to grow by only 10% over the remaining life of the firm. This expectation seems pessimistic given KBAL has grown NOPAT by 22% compounded annually since fiscal 2015 and 19% compounded annually over the past decade.

If KBAL can maintain fiscal 2019 NOPAT margins (5%) and grow NOPAT by just 6% compounded annually over the next decade, the stock is worth \$26/share today – a 24% upside. [See the math behind this reverse 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](#) as shown in the Harvard Business School and MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)".

Below are specifics on the adjustments we make based on Robo-Analyst findings in Kimball International’s fiscal 2019 10-K:

Income Statement: we made \$15 million of adjustments, with a net effect of removing \$1 million in [non-operating income](#) (<1% of revenue). You can see all the adjustments made to KBAL’s income statement [here](#).



Balance Sheet: we made \$197 million of adjustments to calculate invested capital with a net increase of \$10 million. One of the largest adjustments was \$65 million in [asset write-downs](#). This adjustment represented 28% of reported net assets. You can see all the adjustments made to KBAL's balance sheet [here](#).

Valuation: we made \$90 million of adjustments with a net effect of increasing shareholder value by \$46 million. The largest adjustment to shareholder value was \$68 million in [excess cash](#). This adjustment represents 9% of KBAL's market cap. See all adjustments to KBAL's valuation [here](#).

*This article originally published on [October 24, 2019](#).*

*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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## ***Footnotes adjustments matter. We are the ONLY source.***

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We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

**HBS & MIT Sloan research** reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies ([featured by Harvard Business School](#)), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, [Core Earnings: New Data and Evidence](#), shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Quotes from HBS & MIT Sloan professors on our research:

### **Get better research:**

*“...the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications.”* – page 19

### **Pick better stocks:**

*“Trading strategies that exploit cross-sectional differences in firms’ transitory earnings produce abnormal returns of 7-to-10% per year.”* – Abstract

### **Avoid losses from using other firms’ data:**

*“...many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat...”* – page 13

### **Build better models:**

*“Core Earnings [calculated using New Constructs’ novel dataset] provides predictive power for various measures of one-year-ahead performance...that is incremental to their current-period counterparts.”* – page 3-4

### **Exploit market inefficiencies:**

*“These results suggest that the adjustments made by analysts to better capture core earnings are incomplete, and that the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures.”* – page 26

### **Fulfill fiduciary duties:**

*“An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A.”* – page 31



## **DISCLOSURES**

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