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

Nine new stocks make March's Exec Comp Aligned with ROIC Model Portfolio, available to members as of March 13, 2020.

Recap from February's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (-20.7%) underperformed the S&P 500 (-18.7%) from February 14, 2020 through March 11, 2020. The best performing stock in the portfolio was up 3%. Overall, seven out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P from February 14, 2020 through March 11, 2020.

Get the best fundamental research

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "Core Earnings: New Data and Evidence." 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: Kimberly-Clark Corp (KMB: $135/share)

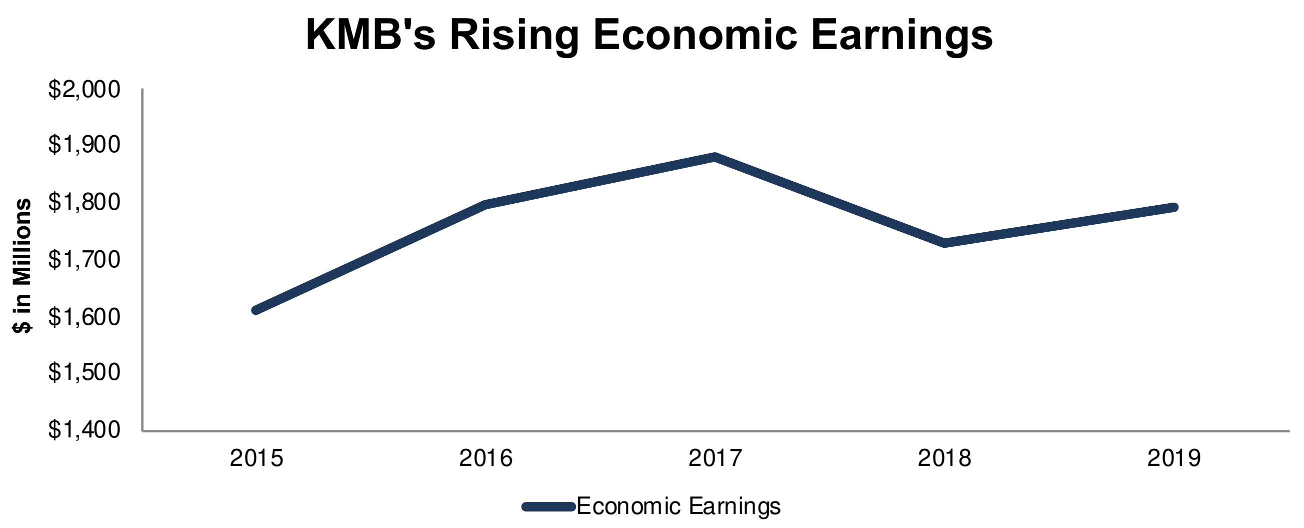
Kimberly-Clark Corp (KMB) is the featured stock in March's Exec Comp Aligned with ROIC Model Portfolio.

We first made KMB a Long Idea in November 2017 and reiterated it in May 2019. Since our initial report, the stock has outperformed the S&P 500 (up 19% vs S&P down 7%) and remains undervalued.

KMB has grown after-tax operating profit (NOPAT) by 2% compounded annually over the past five years and 2% compounded annually over the past two decades. The firm increased its NOPAT margin from 11% in 2014 to 13% in 2019. Additionally, KMB has shown a consistent ability to create shareholder value by generating positive economic earnings every year since 1998.

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 This paper compares our analytics on a mega cap company to Bloomberg and Capital IQ (SPGI) in a detailed appendix.

Figure 1: KMB's Economic Earnings Since 2014



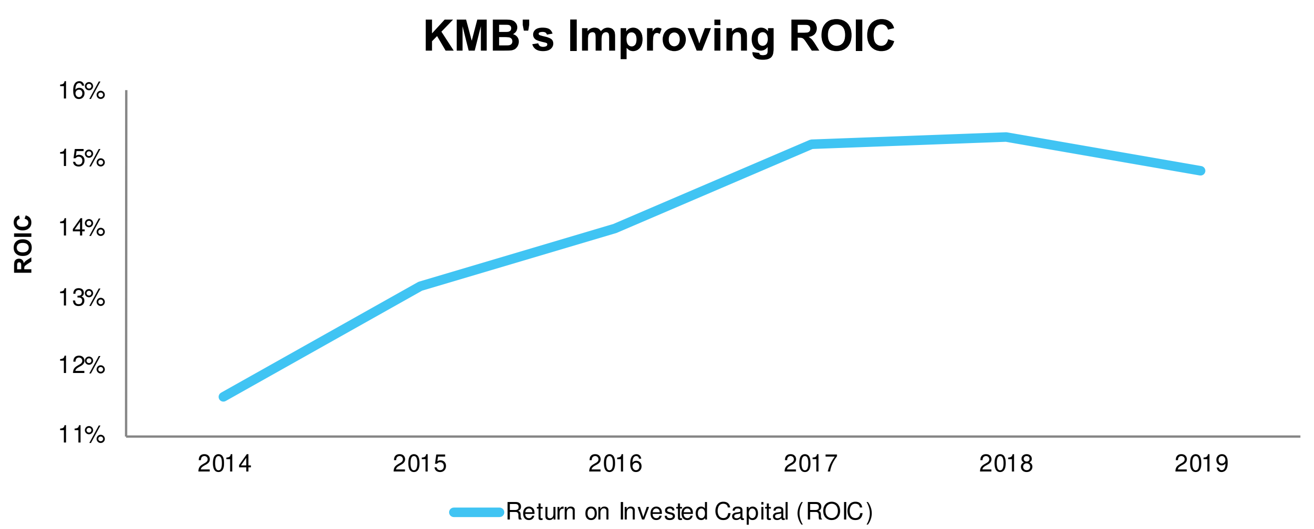
Sources: New Constructs, LLC and company filings

Executives Are Focused on Creating Shareholder Value

53% of KMB executives' compensation consists of performance-based restricted share units (RSU's). The performance objectives for these RSU's are equally weighted between average annual adjusted net sales growth and average adjusted ROIC over a three-year period. In other words, nearly 27% of total executive compensation is tied directly to ROIC performance.

KMB's focus on ROIC ensures intelligent capital allocation. KMB has grown economic earnings year-over-year (YoY) in 11 of the 16 years since KMB first included ROIC in its compensation plan in 2004. More recently, despite falling in 2019, KMB has still increased ROIC from 12% in 2014 to 15% in 2019.

Figure 2: KMB's ROIC Since 2014



Sources: New Constructs, LLC and company filings

KMB Still Has Upside Potential

At its current price of $135/share, KMB has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects KMB's NOPAT to permanently decline by 10%. This seems overly pessimistic given its 2% compounded annual growth rate over the past two decades.

If KMB can maintain NOPAT margins of 13% (equal to 2019 NOPAT margin and the five-year average) and grow NOPAT by just 2% compounded annually for the next decade, the stock is worth $184/share today – a 36% 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 Kimberly-Clark Corp's 2019 10-K:

Income Statement: we made $1.6 billion of adjustments, with a net effect of removing $312 million in non-operating expenses (2% of revenue). You can see all the adjustments made to KMB's income statement here.

Balance Sheet: we made $9.5 billion of adjustments to calculate invested capital with a net increase of $8.1 billion. One of the largest adjustments was $3.3 billion related to other comprehensive income. This adjustment represented 39% of reported net assets. You can see all the adjustments made to KMB's balance sheet here.

Valuation: we made $10.6 billion of adjustments with a net effect of decreasing shareholder value by $10.6 billion. There were no adjustments that increased shareholder value. Apart from total debt, one of the largest adjustments to shareholder value was $937 million in underfunded pensions. This adjustment represents 2% of KMB's market cap. See all adjustments to KMB's valuation here. Despite these subtractions from shareholder value, KMB remains undervalued.

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Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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Footnotes adjustments matter. We are the ONLY source.

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.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **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.

Learn more.

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 20

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 14

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 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, 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 33-34

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