



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

Three new stocks make April's Exec Comp Aligned with ROIC Model Portfolio, available to members as of April 15, 2020.

### Recap from March's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (-1.4%) underperformed the S&P 500 (+2.4%) by 3.8% from March 13, 2020 through April 13, 2020. The best performing stock in the portfolio was up 12%. Overall, four out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P from March 13, 2020 through April 13, 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](#)<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 March: Target Corporation (TGT: \$113/share)

Target Corporation (TGT) is the featured stock in April's Exec Comp Aligned with ROIC Model Portfolio.

We first made TGT a [Long Idea](#) in [April 2015](#) and closed the position in [May 2018](#). We once again made it a Long Idea in [June 2019](#) and reiterated the position in [August 2019](#) and [January 2020](#). Since the June 2019 report, the stock has outperformed the S&P 500 (up 33% vs S&P up 2%), and remains undervalued.

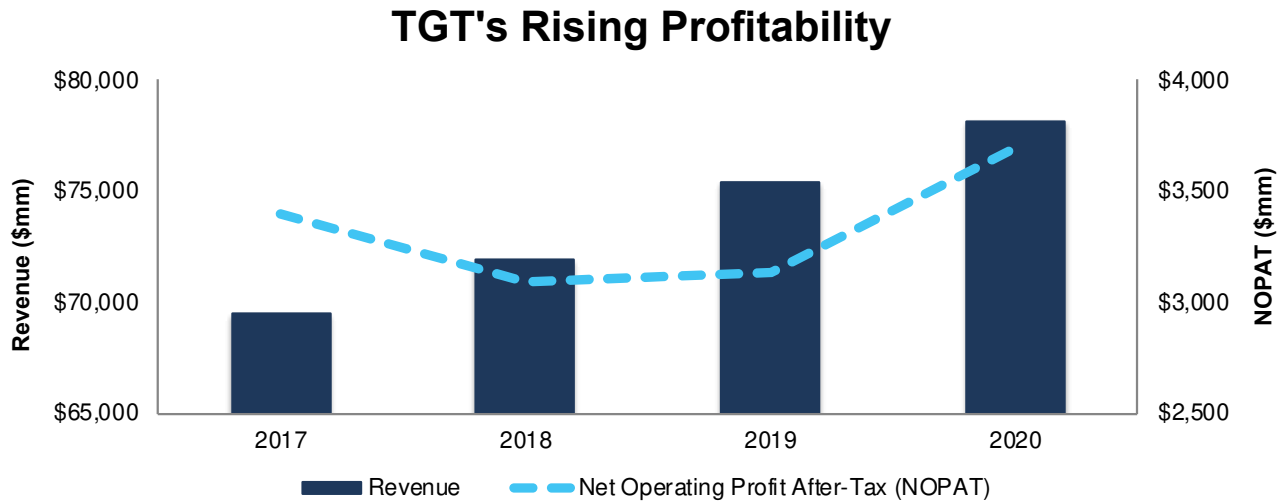
TGT has grown revenue and after-tax profit ([NOPAT](#)) by 2% compounded annually over the past decade. TGT's NOPAT margin increased from 4.6% in 2010 to 4.7% in 2020, while its [invested capital turns](#) improved from 2.0 to 2.4 over the same time. Improvements in both NOPAT margin and invested capital turns drive TGT's ROIC from 9% in 2010 to 11% in 2020.

<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 Bloomberg and Capital IQ (SPGI) in a detailed appendix.



Figure 1: TGT's Revenue & NOPAT Since 2017



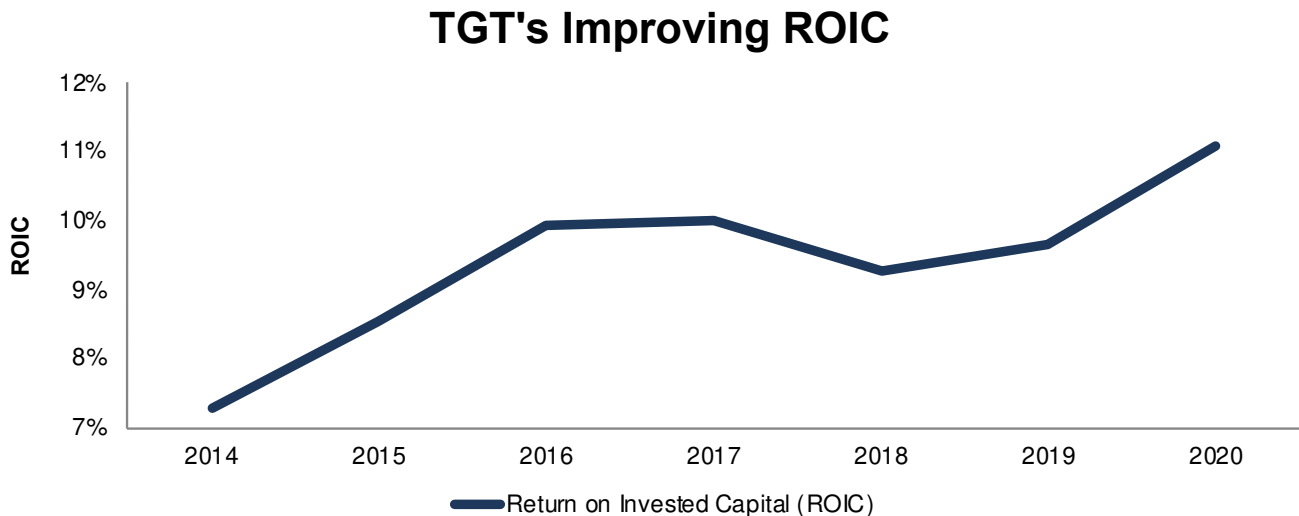
Sources: New Constructs, LLC and company filings

#### Compensation Plan Properly Incentivizes Executives

41% to 43% (depending on position) of TGT executives' compensation [consists](#) of performance-based restricted share units (RSU's). These RSU's are awarded based on the three-year performance of ROIC, adjusted sales growth and EPS growth relative to TGT's retail peer group.

TGT's focus on ROIC helps ensure intelligent capital allocation that helps create shareholder value. TGT first included ROIC in its executive compensation plan in 2014 and has increased ROIC year-over-year (YoY) in five of the six years since then. Per Figure 2, ROIC improved from 7% in 2014 to 11% in 2020.

Figure 2: TGT's ROIC Since 2014



Sources: New Constructs, LLC and company filings

#### TGT's Valuation Offers Upside Potential

At its current price of \$113/share, TGT has a price-to-economic book value ([PEBV](#)) ratio of 1.0. This ratio means the market expects TGT's NOPAT to never meaningfully grow from current levels. This expectation seems overly pessimistic for a firm that has grown NOPAT by 3% compounded annually for the past five years and 5%



compounded annually over the past two decades. Furthermore, TGT [recently reported](#) that it was experiencing unusually strong traffic and sales as guests rely on the firm for essential items during the COVID-19 pandemic.

If TGT can maintain its fiscal 2020 NOPAT margin (5%) and grow NOPAT by just 3% compounded annually for the next decade, the stock is worth \$149/share today – a 32% 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 Target's 2020 10-K:

Income Statement: we made \$832 million of adjustments, with a net effect of removing \$406 million in [non-operating expenses](#) (1% of revenue). You can see all the adjustments made to TGT's income statement [here](#).

Balance Sheet: we made \$10.3 billion of adjustments to calculate invested capital with a net increase of \$6.8 billion. One of the largest adjustments was \$4.0 billion in [asset write-downs](#). This adjustment represented 14% of reported net assets. You can see all the adjustments made to TGT's balance sheet [here](#).

Valuation: we made \$17.6 billion of adjustments with a net effect of decreasing shareholder value by \$17.6 billion. There were no adjustments that increased shareholder value. Apart from [total debt](#), one of the largest adjustments to shareholder value was \$1.1 billion in [net deferred tax liability](#). This adjustment represents 2% of TGT's market cap. See all adjustments to TGT's valuation [here](#). Despite these subtractions from shareholder value, TGT 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.***

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

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- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
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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*



## **DISCLOSURES**

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