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

Five new stocks make June's Exec Comp Aligned with ROIC Model Portfolio, available to members as of June 16, 2020.

Recap from May's Picks

Our Exec Comp Aligned with ROIC Model Portfolio (+6.8%) outperformed the S&P 500 (+6.3%) by 0.5% from May 15, 2002 through June 12, 2020. The best performing stock in the portfolio was up 31%. Overall, Eight out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P from May 15, 2020 through June 12, 2020.

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 June: Kimberly-Clark Corp (KMB: $142/share)

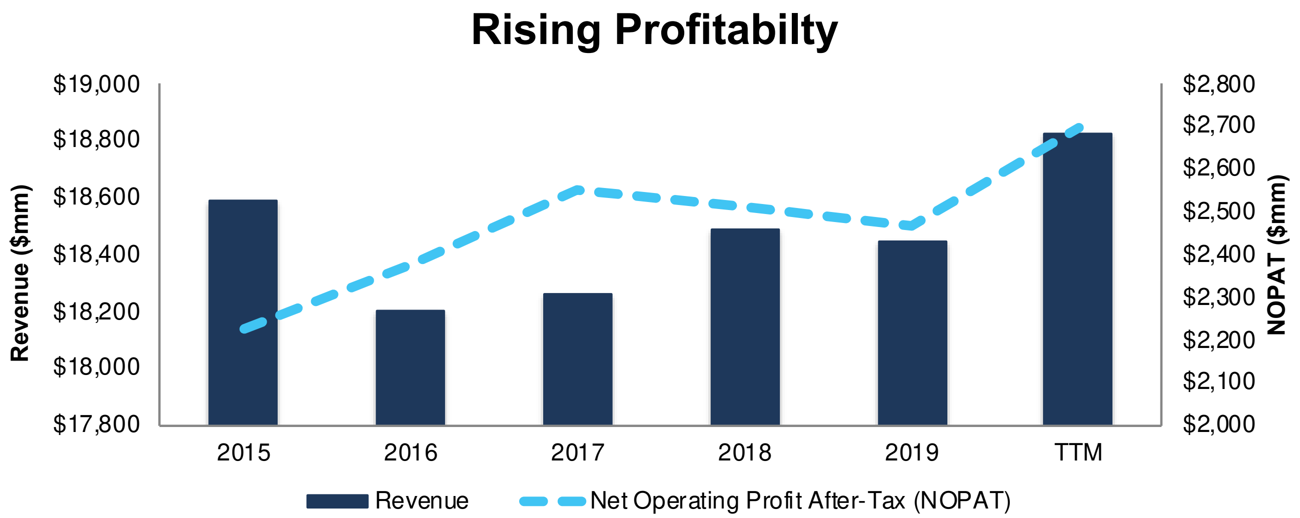
Kimberly-Clark Corp (KMB) is the featured stock in June's Exec Comp Aligned with ROIC Model Portfolio.

We 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 25% vs S&P up 21%) and remains undervalued.

Kimberly-Clark has grown after-tax profit (NOPAT) by 3% compounded annually since 2015. Longer term, Kimberly-Clark has grown NOPAT by 2% compounded annually over the past two decades. Kimberly-Clark's NOPAT margin increased from 12% in 2015 to 14% over the trailing-twelve-months (TTM), while its ROIC improved from 13% to 16% over the same time.

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: Kimberly-Clark's Revenue & NOPAT Since 2015



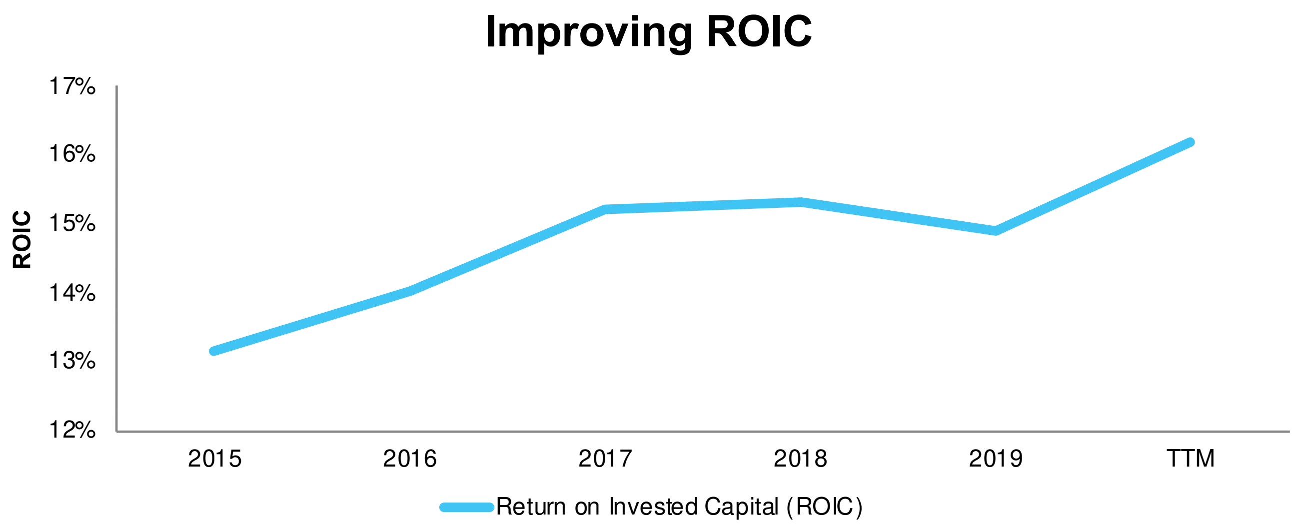
Sources: New Constructs, LLC and company filings

Compensation Plan Properly Incentivizes Executives

Kimberly-Clark's executive compensation plan aligns executives' interests with shareholders' interests by tying compensation to return on invested capital (ROIC). Apart from base salary and annual cash bonuses, KMB executives receive long-term equity compensation in the form of performance based restricted share units. These awards are tied to the achievement of two goals, 3-year average return on invested capital and annual net sales growth, each weighted at 50%.

The focus on improving ROIC helps to ensure prudent stewardship of capital. Per Figure 2, Kimberly-Clark has improved its ROIC from 13% in 2015 to 16% TTM. Kimberly-Clark has averaged a 14% ROIC since 1998.

Figure 2: Kimberly-Clark's ROIC Since 2015



Sources: New Constructs, LLC and company filings

KMB is Undervalued

At its current price of $142/share, KMB has a price-to-economic book value (PEBV) ratio of 0.8 This ratio means the market expects Kimberly-Clark's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 2% compounded annually over the past two decades.

Even if Kimberly-Clark's NOPAT margin falls to 13% (equal to 2019 and the five-year average, compared to 14% TTM) and NOPAT grows by just 2% compounded annually for the next decade, the stock is worth $193/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'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 Kimberly-Clark's income statement here.

Balance Sheet: we made $9.1 billion of adjustments to calculate invested capital with a net increase of $7.7 billion. One of the largest adjustments was $3.3 billion in other comprehensive income. This adjustment represented 39% of reported net assets. You can see all the adjustments made to Kimberly-Clark's balance sheet here.

Valuation: we made $11.4 billion of adjustments with a net effect of decreasing shareholder value by $11.3 billion. 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 Kimberly-Clark's valuation here.

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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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