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

Four new stocks make August's Exec Comp Aligned with ROIC Model Portfolio, available to members as of August 14, 2020.

**Recap from July's Picks**

Our Exec Comp Aligned with ROIC Model Portfolio (+8.0%) outperformed the S&P 500 (+4.8%) from July 15, 2020 through August 12, 2020. The best performing stock in the portfolio was up 25%. Overall, 10 out of the 15 Exec Comp Aligned with ROIC Stocks outperformed the S&P from July 15, 2020 through August 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 August: Amgen Inc. (AMGN: $240/share)**

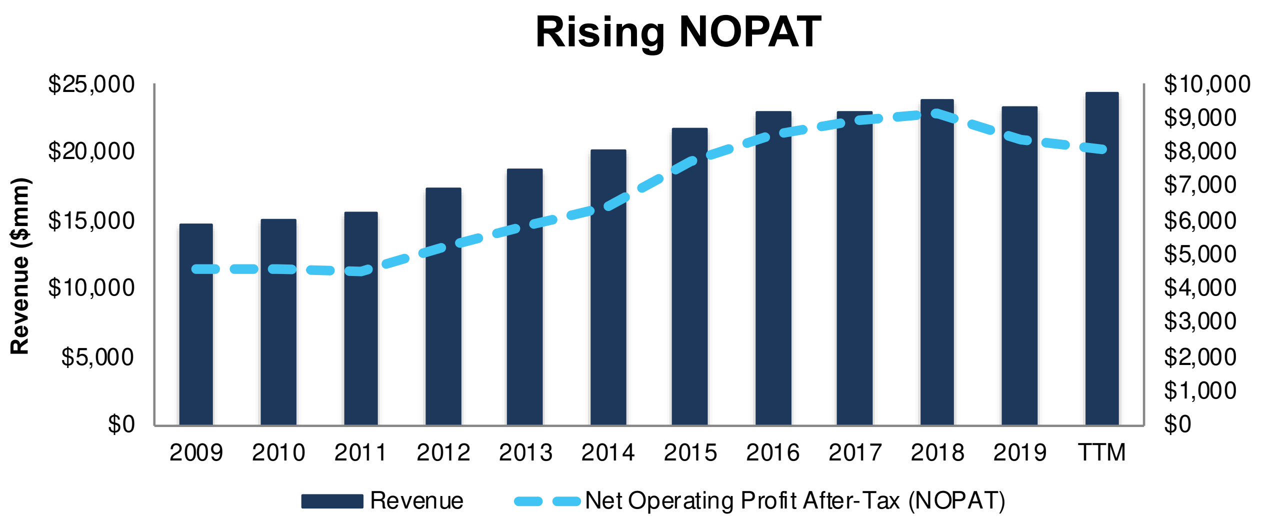
Amgen Inc. (AMGN) is the featured stock in August's Exec Comp Aligned with ROIC Model Portfolio.

We made AMGN a Long Idea in May 2017 and reiterated it in March 2018 and in December 2018. Since our original report, the stock has outperformed the S&P 500 (up 46% vs S&P up 41%) and remains undervalued.

Amgen has grown revenue by 5% compounded annually and after-tax profit (NOPAT) by 6% compounded annually over the past decade. Longer term, Amgen has grown NOPAT by 12% compounded annually over the past two decades. Amgen's NOPAT margin increased from 31% in 2009 to 33% over the trailing-twelve-months (TTM), while its invested capital turns improved from 0.51 to 0.54 over the same time. Rising margins and invested capital turns drive Amgen's ROIC from 16% in 2009 to 18% TTM.

[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: Revenue & NOPAT Since 2009**



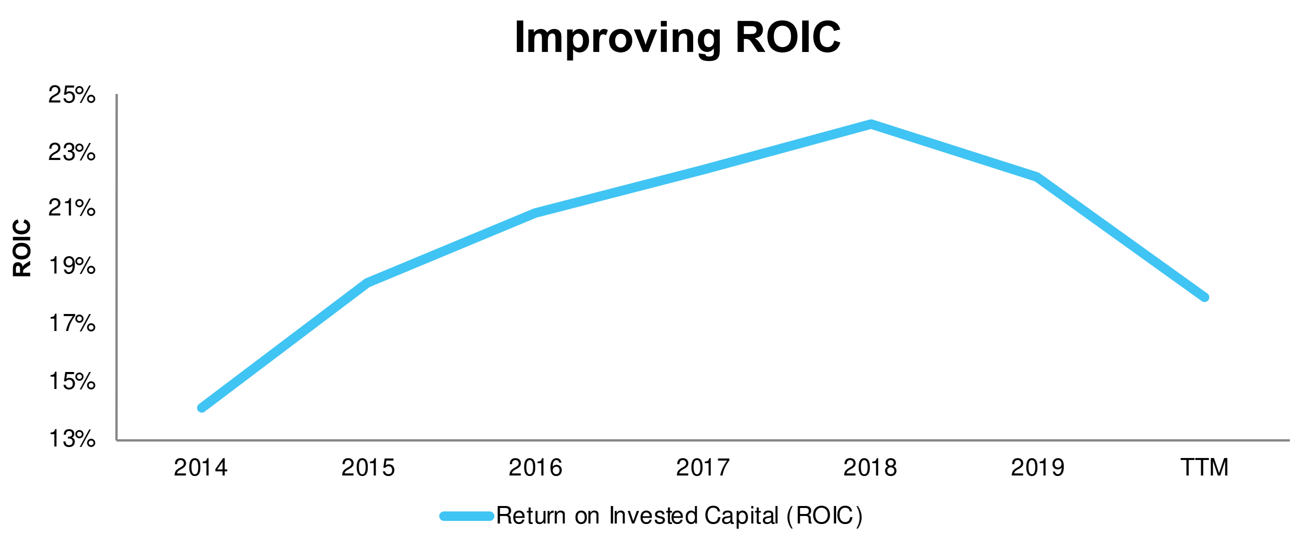

Sources: New Constructs, LLC and company filings

**Compensation Plan Properly Incentivizes Executives**

Amgen's executive compensation plan aligns executives' interests with shareholders' interests by tying compensation to return on invested capital (ROIC). Apart from base salary and short-term incentives, Amgen executives received long-term equity compensation in the form of performance units (50%), stock options (30%), and restricted share units (20%) in 2019. Performance units are tied to the achievement of three-year performance goals for EPS growth, operating margin, and ROIC, which replaced an operating expense goal in 2019.

While we are glad to see Amgen including ROIC in its executive compensation plan, we would prefer an even greater tie to ROIC. Per Figure 2, Amgen has improved its ROIC from 14% in 2014 to 18% TTM, even as it has experienced COVID-related disruption to its business in more recent periods.

**Figure 2: Amgen's ROIC Since 2014**




Sources: New Constructs, LLC and company filings

**AMGN Is Undervalued**

At its current price of $240/share, AMGN has a price-to-economic book value (PEBV) ratio of 0.9 This ratio means the market expects Amgen's NOPAT to permanently decline by 10%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 12% compounded annually over the past two decades.

Even if Amgen's NOPAT margin falls to 29% (10-year low, compared to 33% TTM) and NOPAT grows by just 1% compounded annually for the next decade, the stock is worth $303/share today – a 26% 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 Amgen's 2019 10-K:

Income Statement: we made $2.2 billion of adjustments, with a net effect of removing $534 million in non-operating expenses (2% of revenue). You can see all the adjustments made to Amgen's income statement here.

Balance Sheet: we made $32.3 billion of adjustments to calculate invested capital with a net decrease of $10.4 billion. One of the most notable adjustments was $12.1 billion in midyear acquisitions. This adjustment represented 26% of reported net assets. You can see all the adjustments made to Amgen's balance sheet here.

Valuation: we made $49.9 billion of adjustments with a net effect of decreasing shareholder value by $28.1 billion. Apart from total debt, one of the largest adjustments to shareholder value was $10.9 billion in excess cash. This adjustment represents 8% of Amgen's market cap. See all adjustments to Amgen'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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