

EVA Financial Data

The objective of the Economic Value Added (EVA) framework is to assist investment professionals with decision making for their equity portfolios through EVA's established standard for measuring, analyzing, projecting, valuing, and discounting a firm's underlying economic profit.

The PRVit framework provides an assessment of a firm's risk-adjusted EVA profitability (Quality), contextualizes the firm's market valuation, and compares the assessed Quality to the current level of valuation.

Economic Profitability

EVA, in its simplest form, is a three-line calculation: Sales, less Operating Costs, less Capital Costs. Additionally, EVA can be mathematically defined by the formula below:

$$\text{EVA} = \text{NOPAT (Net Operating Profit After Taxes)} - \text{Capital Charge (Capital} \times \text{Cost of Capital)}$$

Therefore, EVA is profit after all costs, including the cost of providing shareholders with a reasonable return.

The EVA framework converts accounting profit into economic profit, by reversing accounting distortions, to then measure profit, after all associated capital-costs are deducted. To increase EVA, management must increase profits above the opportunity cost of funding any new capital investments.

Valuation

The EVA methodology will generate the same result as discounted cash flow and Price-to-Earnings ratio analyses; however, it provides additional information, including: 1) EVA helps surface situations where growing earnings mask value destruction; 2) EVA provides more information on the balance sheet without losing site of the income statement; 3) EVA is not distorted by terminal capital expenditures; and 4) EVA is specifically designed to calculate how much value management adds.

In the EVA framework:

$$\text{Market Value} = \text{Capital} + \text{Present Value of Future EVA}$$

Using this formula, ISS STOXX EVA can provide additional insights into the market expectations for a company: how much of the Market Value is based on the company's current profitability (Current Value Added) and how much is associated to investors' expectations for future growth (or contraction) of profitability (Future Value Added). To quantify the portion of the stock's Market Value that is dependent on future growth, ISS STOXX EVA uses Future Growth Reliance (FGR). The ratio provides the ability to compare the Future Value Added to peers, industry benchmarks, and the stock's own history.

Outputs

Software

Investor Express (EVAexpress.com) is the flagship product of ISS STOXX EVA. The web-based tool allows clients to analyze companies, screen for potential investment opportunities, compare portfolios to benchmarks, and look at aggregate regional, sector, and industry level information.

Valuation Engine

The ISS STOXX EVA valuation engine delivers expected market values given various forecast assumptions. The model has several options for terminal values.

Data Feeds

Key EVA metrics are provided to clients who can ingest them into their own internal systems. Standard and customized feeds are available on a daily and monthly basis.

Research

Weekly research reports provide insights into sectors, industries, and themes observed within the EVA framework. ISS STOXX EVA's quantitative research outputs are supported by fundamental and thematic research, analyzing global equity markets utilizing both EVA and PRVit frameworks. ISS STOXX EVA's sector-level research, and 'Industry Snapshots' qualitatively examine the attractiveness of sectors and industries at a global aggregate level: providing data-driven insights into financial trends, EVA-related performance, and market implied expectations. The reports showcase a tabulated PRVit-based analysis of the largest and most attractive firms within each industry.

ISS STOXX EVA's research team also provides regular quantitative-based reports, which summarize the performance of the PRVit stock selection model, incorporating performance reviews of its factors: Profitability, Risk and Value. The analysis is categorized by regions, sectors, and market cap size, to examine the underlying quantitative trends, while identifying seemingly attractive investment themes and industries. ISS STOXX EVA's research outputs are designed to give clients a comprehensive understanding of global equity markets.

Advisory

ISS STOXX EVA provides company-specific analysis to clients via conference calls or e-mails. The equity research team also delivers portfolio analysis to identify factor exposure of client portfolios versus indexes or peers.

Research Process

- **Data collection:** ISS STOXX EVA collects data from Standard & Poor's Capital IQ. EVA computation starts with the companies' "as reported" financials through Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), and makes predefined, rules-based adjustments to those reported financials. The foundation is economic profit, not accounting profit, which is achieved through 20 plus conceptual accounting adjustments. Measures of NOPAT and Capital incorporate these adjustments: for example, instead of deducting Research & Development and Advertising expenditure from net income, it is added to Capital, subjected to a capital charge, and then amortized over a defined period, specific to each industry. To mitigate any computational bias, adjustment rules must be codable as formulas that are broadly applied, irrespective of individual company factors or human judgement. The derivative EVA metrics are updated when earnings reports are published, allowing for regular and timely updates.
- **Quality assurance and data validation:** Automated data quality checks are routinely performed, with systematic identification of incorrect data, which is then corrected, or statistically normalized. System-level improvements are designed, evaluated within a User Acceptance Testing (UAT) environment, and then implemented.
- **Final reports:** ISS STOXX EVA's Investor Express integrates quantitative and fundamental research outputs within a singular platform. Key metrics are illustrated in either graphical (chart) or tabulated form. Firm-level and aggregate EVA Income Statements provide an overview of the framework-related line items. ISS STOXX EVA's fundamental research outputs are published onto the Investor Express platform and sent to clients directly.

Use of Estimated Data

ISS STOXX EVA uses estimated or modelled data if the data disclosed by companies, or third parties are deemed insufficient or inadequate:

- IBES consensus sales forecasts are used within the Investor Express software to seed market-implied EVA metrics. When consensus sales forecasts are not available, ISS STOXX EVA utilizes a proprietary regression model to project the sales. This process is adopted for c.46% of ISS STOXX EVA coverage companies which do not have first year consensus sales.
- ISS STOXX EVA also uses certain estimates to grow out full financial data when companies fail to report items on a quarterly basis. Grow-out routines use corresponding metrics from annual filings to estimate their quarterly values and this is done for c.61% of the firms covered.

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