

Markets Factor in a Soft Landing

EVA Fundamentals have somewhat surprisingly moved sideways through the first quarter of 2023 (Figure 1), as EBITDAR Margin has offset further contractions in Sales growth and a worsening picture for asset efficiency (Figure 2). I say surprisingly, as given the inflationary cost pressures for wages, transportation, and material costs, EVA growth could have easily contracted further. So far, economic profitability in aggregate has been resilient, supported by cost cutting. The additional saving grace is that investment so far has not picked up aggressively and Sales growth, albeit on a trailing four-quarter basis, has remained positive.

Figure 1: Global EVA Fundamentals

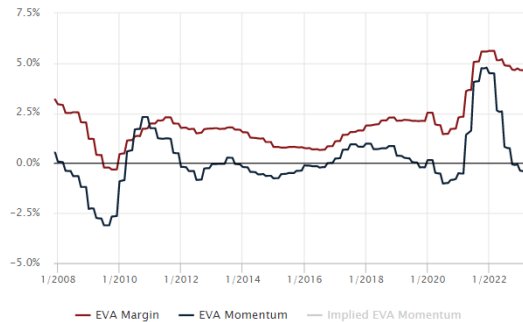
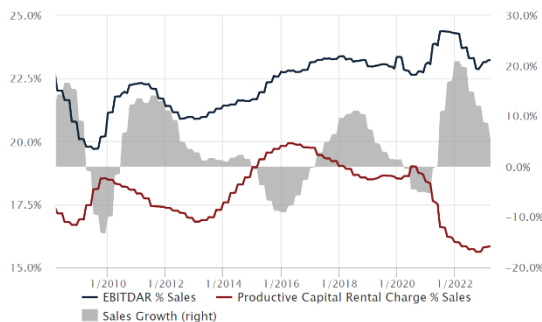


Figure 2: Global EVA Drivers



With U.S. CPI data seeing a m/m decline with yesterday's release (although notably oil prices have gone back up since March, which will add inflationary pressure) the market has increasingly factored in a soft landing. The fact that EVA Momentum has not turned further negative is supportive, but with EVA Margin 150bps above the previous peak, the feeling is that we still need to see significant value destruction before turning positive. The market is currently implying that we see economic value creation from here, with a positive Future Growth Reliance (Figure 3).

Figure 3: Global Future Growth Reliance (FGR)



Key Points

- Global EVA Fundamentals have been moving sideways through 2023.
- EBITDAR Margin has been a supportive EVA Driver while Sales Growth and Productive Capital Charge move unfavorably.
- Expectations (FGR) are for economic value creation and reflect an economic soft landing.

PRVIt Framework

PRVIt is a platform that translates underlying EVA Fundamentals into EVA metrics (Profitability, Risk, Value) that can be ranked and then compared relative to the broader market or intra-industry. To be clear, PRVIt is not a black box ranking system. PRVIt systematically links company fundamentals and market values to economic (EVA) metrics and the resulting score is a percentile rank. In other words, a company with a PRVIt rank of 80 is in the 80th percentile in its industry with respect to its underlying economics relative to the price of the stock in the market. Higher PRVIt is better. When fundamentals exceed valuation, the overall PRVIt ranking will move higher.

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About ISS EVA

We are an independent equity research provider offering investing insights using our proprietary

Economic Value Added (EVA) framework.

Our experienced team of global analysts offers both fundamental and quantitative

company analysis on our +24,000 stock

universe.

Visit our website www.EVAexpress.com

Global Sector View

In **Figure 4** we show the average EVA data and PRVit scores for each of the global sectors for firms with a market cap over \$1bn. The table is sorted by the average share price return YTD.

Figure 4: Global Sector EVA Data

Sector	Average of EVA Margin (%)	Average of EVA Momentum (%)	Average of PRVit Score	Average of Profitability Score (P)	Average of Risk Score (R)	Average of Valuation Score (V)	Average of Share Price Performance Ytd (%)
IT	0.8%	-1.0%	47	54	47	67	20.3%
Comm Services	-0.6%	-2.0%	51	45	52	53	13.4%
Cons Discretionary	0.6%	1.4%	48	52	52	56	7.7%
Materials	4.4%	0.2%	49	52	50	50	7.1%
Health Care	1.5%	-1.8%	52	50	48	66	7.0%
Industrials	1.2%	0.7%	49	50	44	54	7.0%
Consumer Staples	3.7%	-0.3%	50	52	35	59	3.8%
Energy	7.7%	16.1%	49	66	66	42	2.6%
Utilities	0.5%	-1.1%	53	39	48	47	2.5%
Financials	10.9%	-1.3%	49	59	46	46	0.2%
Grand Total	3.3%	0.4%	49	53	48	55	7.5%

What Was the Market Outlook for the Beginning of the Year?

Below we show the expected outcomes from an EVA perspective for each of the scenarios presented at the [beginning of the year](#). We suggested a sustained China recovery would likely see a strong recovery in EVA Momentum and a rapid increase in investor expectations for economic value creation going forward. Cyclical and value sectors would likely outperform in that scenario. In the base-case, inflation peaks in the first half of 2023 and central banks begin to slow/reverse the increased interest rate trajectory. Stock picking will likely be key and both growth and value will provide opportunities, while investors are likely to avoid the more defensive areas of the market under this scenario. A banking crisis and oil shock were not factored in, however, so the base case remains for now.

Scenario-Based EVA Outcomes from the Start of the Year

Scenario	Assumption	Outcome
Upside	Sustained Rebound in China.	Strong recovery in EVA Momentum. Rapid increase in expectations. Buy Value and Cyclical
	Softening in inflation and more dovish central banks.	
Base-Case	Inflation peaks. Central Banks react to slowing growth.	Stock picking: Buy Growth and Value. Avoid Defensives
Downside	Aggressive central bank tightening, as growth slows further, leading to policy mistakes.	Buy Defensives.
	China reinstates zero-COVID policy.	

China is Poised for Recovery

China EVA Drivers (**Figure 5**) show that the three EVA Drivers have moved in an unfavorable direction, with Sales growth and EBITDAR Margin contracting in 2023 and Capital Intensity moving unfavorably. EVA Momentum (**Figure 6**) has reached a low that has surpassed the 2016 slow down and GFC.

Figure 5: China EVA Drivers

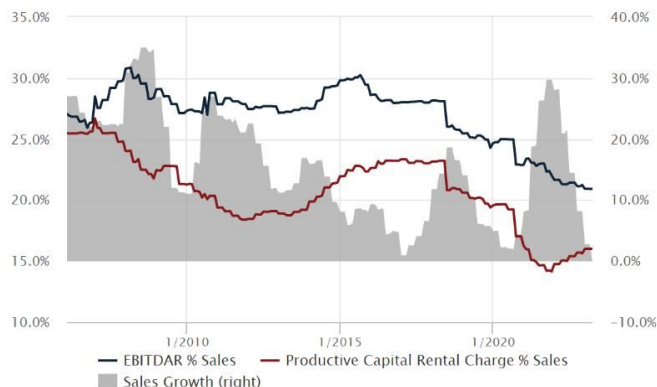
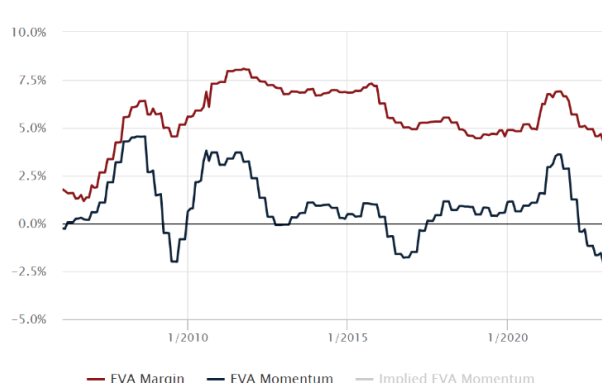


Figure 6: China EVA Fundamentals



China Expectations

Current Value Added (CVA) took a further leg down in Q1 (Figure 7), as investor expectations for value creation (lower level of value destruction) bounced from the October low but remain negative (Figure 8).

Figure 7: China Enterprise Value Components

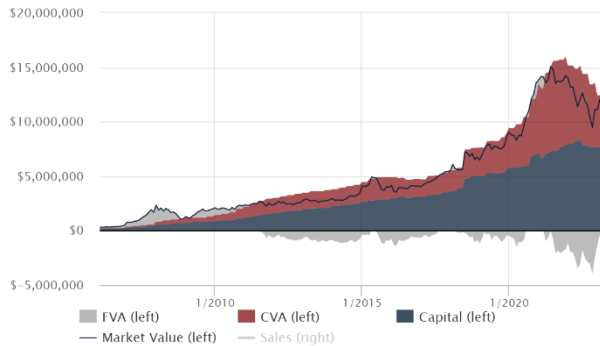
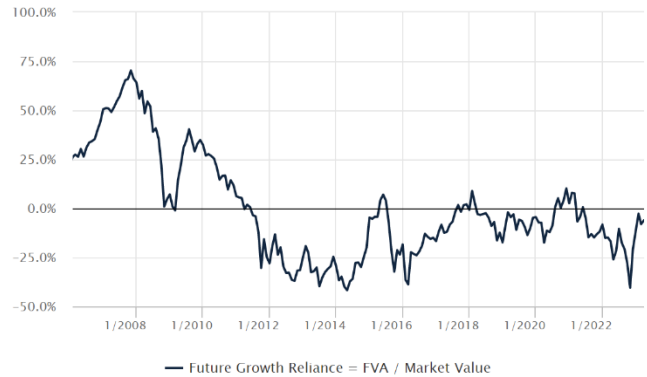


Figure 8: China Future Growth Reliance (FGR)



What is Cheap?

Figure 9 shows the global sectors, industries, and sub-industries that have a Valuation score below 40 (Cheap) based off EVA coverage, with a market cap over \$1bn. Regional Banks, unsurprisingly given the recent banking crisis, is trading with a low Valuation score. Marine Transportation continues to see a de-rating at this point, with current Profitability remaining strong.

Figure 9: Global Low Valued Sectors and Industries

Sector/ Industry	Average of EVA Margin (%)	Average of EVA Momentum (%)	Average of PRVit Score	Average of Profitability Score (P)	Average of Risk Score (R)	Average of Valuation Score (V)	Average of Share Price Performance Ytd (%)
Regional Banks	13.4%	2.3%	51	63	37	28	-11.4%
Housewares & Specialties	-0.9%	-3.0%	51	37	56	29	-1.4%
Marine Transportation	20.8%	10.0%	79	78	68	29	7.2%
Integrated Oil & Gas	7.6%	11.2%	65	74	63	29	7.2%
Paper Products	2.3%	0.4%	55	45	54	30	-2.6%
Homebuilding	7.5%	1.7%	82	72	36	30	18.1%
Commercial Printing	2.7%	1.2%	67	53	26	30	36.9%
Broadcasting	1.1%	-1.5%	74	42	39	31	8.7%
Paper & Forest Products	4.7%	-0.5%	59	51	51	35	-1.9%
Security & Alarm Services	4.0%	0.0%	60	50	42	35	3.7%
Banks	18.2%	2.7%	43	68	45	37	-3.2%
Steel	6.9%	-1.6%	61	53	52	37	6.1%
Computer & Electronics Retail	-1.7%	-1.2%	59	43	36	37	3.7%
Oil & Gas Exploration & Production	17.4%	35.1%	62	79	74	38	0.2%
Cable & Satellite	-2.1%	-0.1%	57	37	58	38	2.5%
Diversified Chemicals	3.9%	2.2%	58	55	39	39	1.1%
Silver	-22.1%	-14.1%	12	9	81	39	6.8%
Office Services & Supplies	-1.6%	-2.5%	56	43	26	39	-6.4%
Multi-Sector Holdings	-3.3%	-2.5%	54	47	52	39	15.3%
Oil & Gas Drilling	-19.9%	20.7%	29	48	78	39	8.2%

About ISS EVA

We are an independent equity research provider offering investing insights through the use of our proprietary Economic Value Added (EVA) framework. EVA converts accounting profits into economic profits and charges businesses for the use of Invested Capital. EVA is superior to traditional measures of profit because it is comparable across companies, industries, and countries, links to a consistent, transparent valuation framework, and provides a unique, unbiased view of Quality, Value, and Growth.

Our experienced team of analysts offers both fundamental and quantitative company analysis through written research, bespoke research, a stock selection model, an online analytical tool offering 24,000+ companies as viewed through the EVA framework, custom screening, and portfolio analysis.

Key EVA Concepts

The value of a firm = Capital + Present Value of EVA

If EVA is increasing then the intrinsic value of the firm is too, suggesting that market value should follow (and vice versa).

EVA = NOPAT - Capital Charge

EVA is profit after all costs, including the cost of giving shareholders a decent return.

EVA Margin = EVA / Sales

A true economic profit margin covering income and asset efficiency. Our EVA Income Statement examines EVA's line-item drivers and offers key insights into business profitability.

EVA Momentum = Δ EVA / Sales

An incremental EVA growth rate indicator and key valuation signal and screening measure. The more positive the Momentum, the greater the growth in EVA, and upward pressure on shareholder returns. Inflections in EVA Momentum are an early and more reliable indicator of stock price inflections.

EVA Shock = Δ EVA Momentum

Changes in EVA Momentum is a powerful signal within our framework, with significant relationship with stock price performance.

Market Implied Momentum (MIM)

The annual EVA improvement required for 10 years to justify the prevailing market enterprise value, expressed as a percent of sales; represents a market implied, long-range EVA margin improvement target.

Future Growth Reliance (FGR) = (Market implied value of future EVA growth) / EV

Measures the % of a company's total enterprise value represented by expectations for future growth in EVA. FGR is key to understanding embedded expectations today and versus history. A low FGR versus history coupled with improving EVA trends indicates that the market is not pricing in the improving business model.

Additional Resources

evaExpress.com ([link](#)): Our online offering provides a comprehensive suite of fundamental and quantitative tools utilizing the EVA framework

EVA for Investors ([link](#)): A full introduction to the key EVA concepts and metrics

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