New Stocks in August's Dividend Growth Model Portfolio

Seven new stocks made August's Dividend Growth Stocks Model Portfolio, which was made available to members on August 31, 2017.

Recap from July's Picks

Our Dividend Growth Stocks Model Portfolio underperformed the S&P 500 last month. The Model Portfolio fell -1.9% on a price return basis and -1.6% on a total return basis. The S&P 500 rose 0.2% on a price and total return basis. The portfolio's best performing stock was Ross Stores (ROST), which was up 7%. Overall, 10 out of the 30 Dividend Growth Stocks outperformed the S&P during the 7/28/17 to 8/30/17 measurement period, which marked this portfolio's second measurement period since inception.

The long-term success of our model portfolio strategies highlights the value of our Robo-Analyst technology, which scales our forensic accounting expertise (featured in Barron's) across thousands of stocks.

The methodology for this model portfolio mimics an All-Cap Blend style with a focus on dividend growth. Selected stocks earn an Attractive or Very Attractive rating, generate positive free cash flow (FCF) and economic earnings, offer a current dividend yield >1%, and have a 5+ year track record of consecutive dividend growth. This model portfolio is designed for investors who are more focused on long-term capital appreciation than current income, but still appreciate the power of dividends, especially growing dividends.

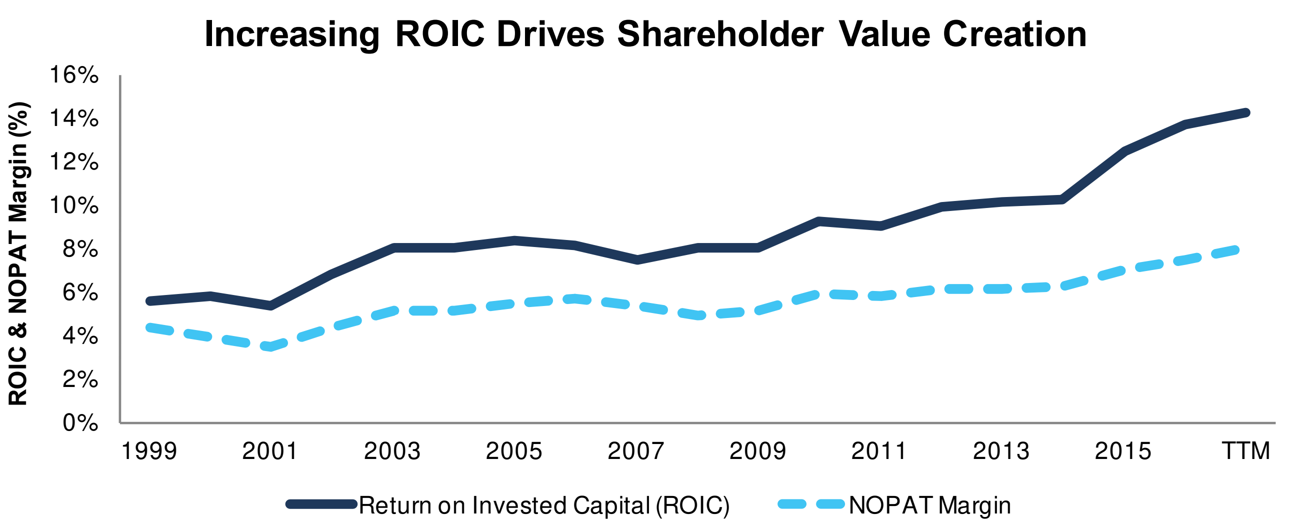
New Stock Feature for August: Cracker Barrel Old Country Store (CBRL: $143/share)

Cracker Barrel Old Country Store (CBRL), a concept restaurant operator with 643 locations in 44 states, was one of seven additions to our Dividend Growth Stocks Model Portfolio in August. CBRL was also featured as a Long Idea in March 2017.

Over the past decade, CBRL's revenue has grown 2% compounded annually. After-tax profits (NOPAT) have grown 6% compounded annually over the same period. Over the past three years, CBRL's revenue has grown 3% compounded annually while NOPAT growth has increased to 8% compounded annually. This acceleration in NOPAT growth is attributable to margin improvement. CBRL's NOPAT margin has increased to 8% over the trailing twelve months (TTM) from 6% in 2012 and 5% in 2007.

CBRL's return on invested capital (ROIC) (14% TTM) ranks in the second-quintile of our coverage universe. CBRL's ROIC has also exhibited a consistent upward trajectory when compared to 10% in 2012 and 8% in 2007.

Figure 1: CBRL's Steadily Improving Profitability



Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

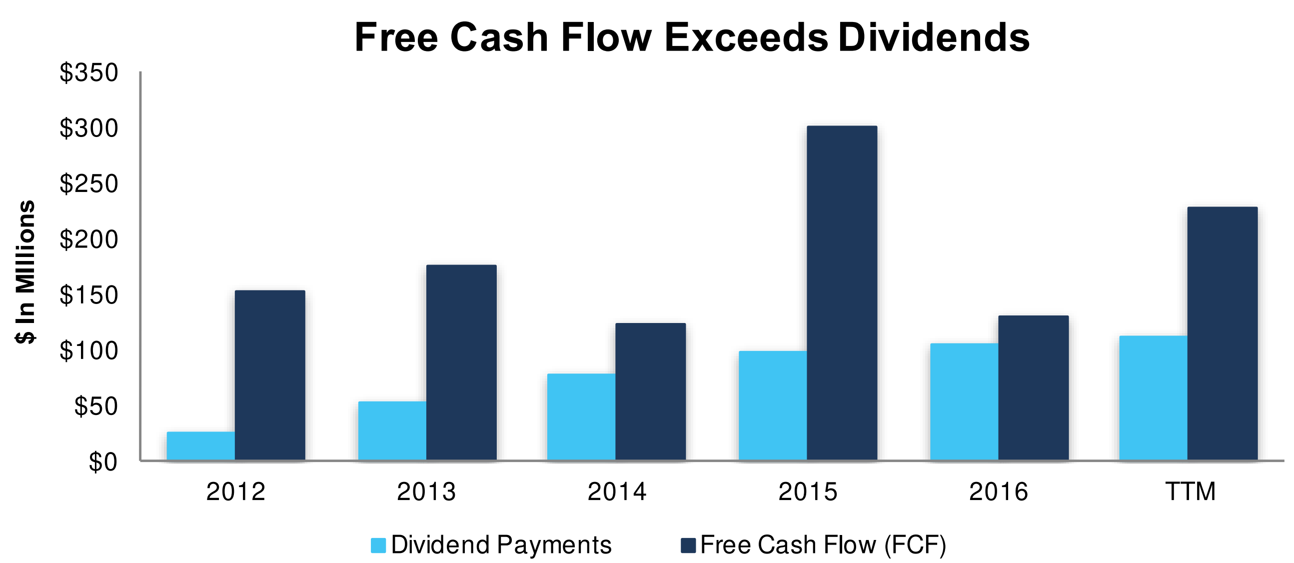
CBRL has increased its regular dividend for seven consecutive years and nine out of the past ten years. CBRL's current annualized dividend of $4.80/share reflects 28% compound annual growth from the $1.40/share dividend paid in 2012. CBRL's growing profits and free cash flow have fueled dividend growth in the past, and we expec the same for the future.

Over the past five years, CBRL has generated cumulative FCF of $1 billion (28% of market cap) and paid out cumulative dividends of $447 million. CBRL's $228 million of FCF over the trailing twelve months represents 200% of the annual cash dividend payment based on a $4.80/share annualized dividend. Stated differently, CBRL's current regular dividend equates to a 50% FCF payout ratio.

In addition to the regular dividend, CBRL has paid progressively larger special dividends of $3.00, $3.25 and $3.50 over the past three years. FCF has exceeded total dividend payments over the past three years even when including these large special dividends.

Companies with FCF well in excess of dividend payments provide higher quality dividend growth opportunities because we know the firm generates the cash to support the current dividend as well as a higher dividend. On the flip side, the dividend growth trajectory of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or sustain its dividend because of inadequate free cash flow.

Figure 2: CBRL's Free Cash Flow (FCF) vs. Regular Dividend Payments



Sources: New Constructs, LLC and company filings

Underappreciated Dividend Growth Stock with Attractive Risk-Reward

At its current price of $143/share, CBRL has a has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects CBRL's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm with a history of consistent NOPAT growth and a differentiated concept that is performing far better than the broader restaurant industry.

If CBRL can maintain current NOPAT margins (8% TTM) and grow NOPAT by 2% compounded annually over the next decade, the stock is worth $185/share today – a 29% upside. In a more optimistic scenario of 3% compound annual NOPAT growth over the next decade, the stock is worth $210/share today – a 47% upside.

CBRL represents an attractive risk-reward opportunity for investors and a textbook addition to our Dividend Growth Stocks Model Portfolio due to: meaningful upside potential rooted in low market expectations, consistent dividend growth, and FCF generation that exceeds dividend payments by a comfortable margin.

Impact of Forensic Accounting That You Can Audit

Our Robo-Analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill fiduciary duties. In order to derive the true recurring cash flows, an accurate invested capital, and a real shareholder value, we made the following adjustments to Cracker Barrel Old Country Store's 2016 10-K:

Income Statement: we made $60 million of adjustments with a net effect of removing $28 million in non-operating expense (1% of revenue). We removed $44 million related to non-operating expenses and $16 million related to non-operating income. See all adjustments made to CBRL's income statement here.

Balance Sheet: we made $614 million of adjustments to calculate invested capital with a net increase of $458 million. The most notable adjustment was $450 million (40% of reported net assets) related to off-balance sheet operating leases. See all adjustments to CBRL's balance sheet here.

Valuation: we made $1.2 billion of adjustments with a net effect of decreasing shareholder value by $871 million. The largest adjustment to shareholder value was $850 million in total debt, which includes $450 million of off-balance sheet operating leases as noted above. This operating lease adjustment represents 13% of CBRL's market value. Despite the decrease in shareholder value, CBRL remains undervalued.

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Disclosure: David Trainer, Kenneth James, and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.

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4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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