



## Featured Stock in January's Safest Dividend Yields Model Portfolio

Twelve new stocks make our [Safest Dividend Yield Model Portfolio](#) this month, which was made available to members on January 24, 2019.

### Recap from December's Picks

Our Safest Dividend Yields Model Portfolio outperformed the S&P 500 last month. The Model Portfolio rose 8.5% on a price return basis and 9.0% on a total return basis. The S&P 500 rose 6.3% on a price return basis and 6.9% on a total return basis. The best performing large cap stock was up 21% and the best performing small cap stock was up 23%. Overall, 9 out of the 20 Safest Dividend Yield stocks outperformed the S&P in December.

Get the best fundamental research

This Model Portfolio leverages our [Robo-Analyst technology](#)<sup>1</sup>, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.<sup>2</sup>

This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating, have positive free cash flow and [economic earnings](#), and offer a dividend yield greater than 3%. Companies with strong [free cash flow](#) provide higher quality and safer dividend yields because we know they have the cash to support the dividend. We think this portfolio provides a uniquely well-screened group of stocks that can help clients outperform.

### Featured Stock for January: Lam Research Corporation (LRCX: \$173/share)

Lam Research Corporation (LRCX) is the featured stock in January's Safest Dividend Yield Model Portfolio.

LRCX was featured as a Long Idea in [May 2018](#) and is down 15% while the S&P 500 is down 1% since publish date. However, the stock has bounced back by ~23% so far in 2019.

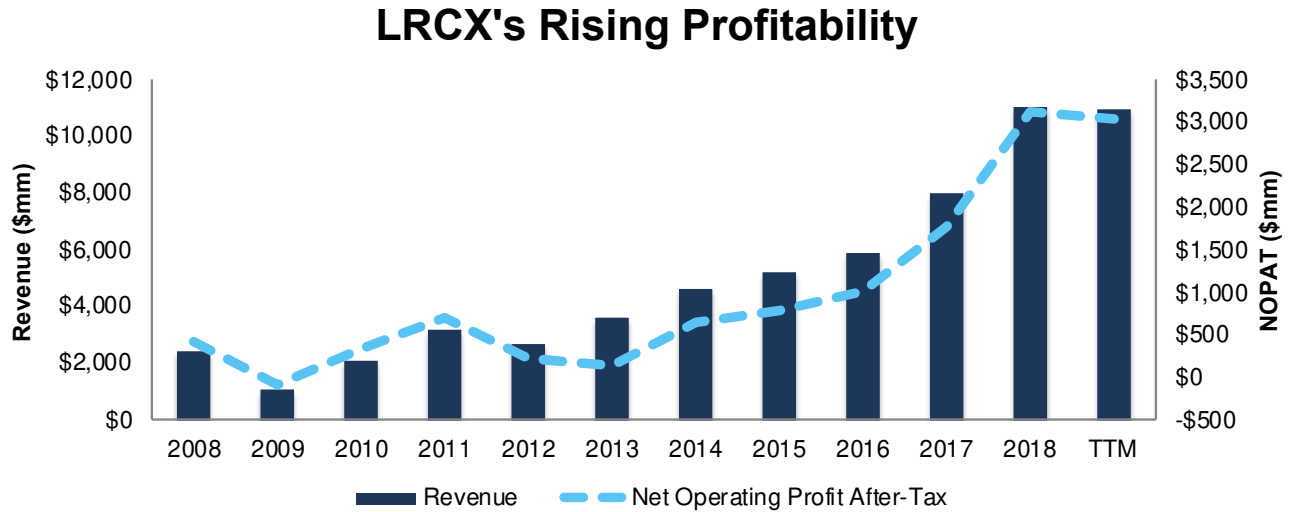
LRCX has grown revenue by 16% compounded annually over the past decade, and its after-tax operating profit ([NOPAT](#)) has grown 22% compounded annually over the same time. LRCX's NOPAT margin has increased from 4% in 2013 to 27% over the last twelve months (TTM). The company has also improved its return on invested capital ([ROIC](#)) from 3% in 2013 to a top-quintile 53% TTM.

<sup>1</sup> Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

<sup>2</sup> Ernst & Young's recent white paper "[Getting ROIC Right](#)" demonstrates the superiority of our stock research and analytics.



Figure 1: LRCX's Revenue and Profit Growth Since 2008



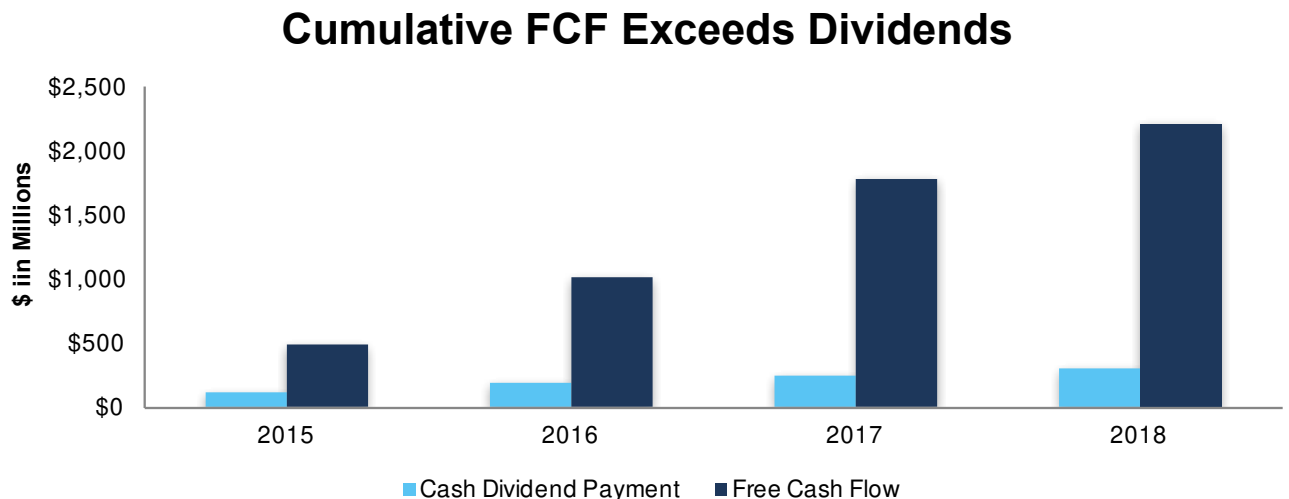
Sources: New Constructs, LLC and company filings

#### LRCX's Free Cash Flow Supports Dividend Payments

[After initiating quarterly dividends in 2014](#), LRCX has increased its quarterly dividend payment every year, from \$0.18/share to \$1.10/share in 2018, or 57% compounded annually. This increase in dividend payments has been supported by LRCX's [free cash flow](#). From 2015 to 2018, LRCX generated a cumulative \$5.5 billion (21% of market cap) in FCF while paying \$857 million in dividends.

Companies with strong free cash flow provide higher quality dividend yields because we know the firm has the cash to support its dividend. On the flip side, dividends from companies with low or negative free cash flow cannot be trusted as much because the company may not be able to sustain paying dividends.

Figure 2: LRCX's FCF vs. Dividends Since 2015



Sources: New Constructs, LLC and company filings



### LRCX Remains Undervalued

At its current price of \$173/share, LRCX has a price-to-economic book value ([PEBV](#)) ratio of 0.8. This ratio means the market expects LRCX's NOPAT to permanently decline by 20%. This expectation seems pessimistic given that LRCX has grown NOPAT by 22% compounded annually since 2008.

If LRCX can maintain 2018 NOPAT margins (28%) and grow NOPAT by just 5% compounded annually for the next 10 years, the stock is worth \$304/share today – a 76% upside. [See the math behind this dynamic 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](#). Below are specifics on the adjustments we make based on Robo-Analyst findings in LRCX'S 2018 10-K:

Income Statement: we made \$948 million of adjustments with a net effect of removing \$746 million in [non-operating expenses](#) (7% of revenue). See all adjustments made to LRCX's income statement [here](#).

Balance Sheet: we made \$6.8 billion of adjustments to calculate invested capital with a net decrease of \$4.1 billion. The most notable accounting distortion to reported net assets for LRCX in 2018 is \$417 million due to [asset write downs](#), which is 4% of reported net assets. See all adjustments to LRCX's balance sheet [here](#).

Valuation: we made \$5.6 billion of adjustments with a net effect of increasing shareholder value by \$1.3 billion. The largest adjustment to shareholder value was \$3.4 billion in [excess cash](#). This adjustment represents 13% of LRCX's market value.

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*Disclosure: David Trainer, Andrew Gallagher, Kyle Guske II, and Sam McBride receive no compensation to write about any specific stock, style, or theme.*

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New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

### ***To fulfill the Duty of Care, research should be:***

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
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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