Featured Stock in January's Dividend Growth Model Portfolio

Eight new stocks make our Dividend Growth Stocks Model Portfolio this month, which was made available to members on January 28, 2021.

Recap From December's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (+4.5%) outperformed the S&P 500 (+3.2%) by 1.3% from December 30, 2020 through January 26, 2021. On a total return basis, the Model Portfolio (+4.7%) outperformed the S&P 500 (+3.2%) by 1.5% over the same time. The best performing stock was up 32%. Overall, 16 out of the 30 Dividend Growth Stocks outperformed the S&P 500 from December 30, 2020 through January 26, 2021.

More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research. Our proprietary Robo-Analyst technology[1] scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

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.

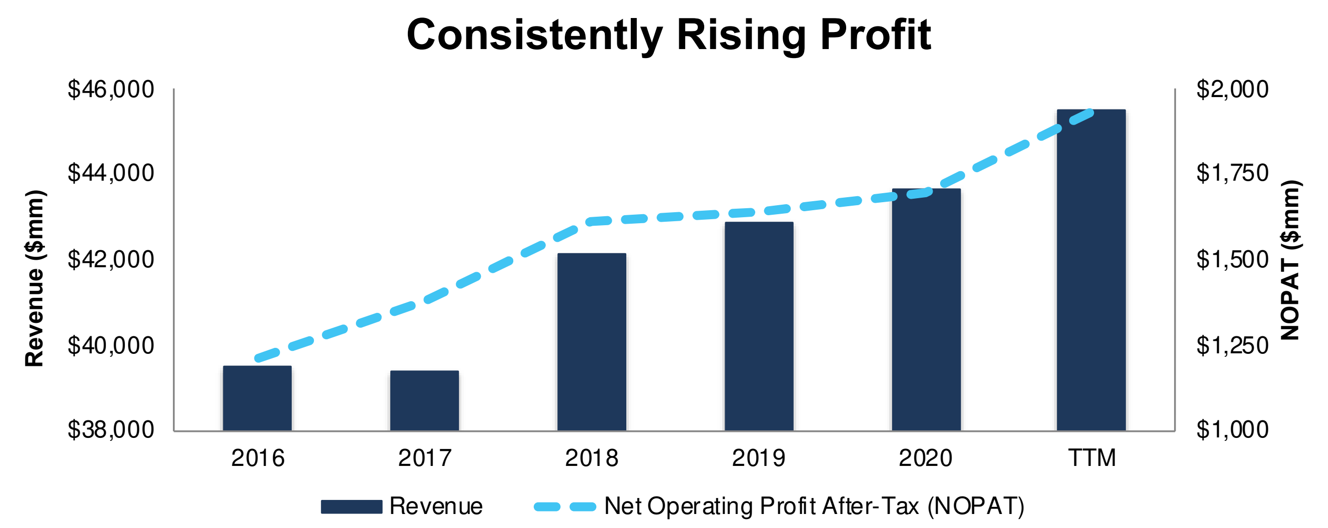
Featured Stock From January: Best Buy Co, Inc. (BBY: $109/share)

Best Buy Co, Inc. (BBY) is the featured stock from January's Dividend Growth Stocks Model Portfolio. Best Buy was also one of our best performing Long Ideas in 2020 and remains undervalued.

Best Buy has grown net operating profit after-tax (NOPAT) by 7% compounded annually over the past five years and 10% compounded annually over the past two decades. The firm's NOPAT margin has increased from 3% in fiscal 2016 to 4% over the trailing-twelve-months (TTM), while return on invested capital (ROIC) has improved from 12% to 21% over the same time.

[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models and financial ratios are superior to Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

Figure 1: Best Buy NOPAT & Revenue Since Fiscal 2016



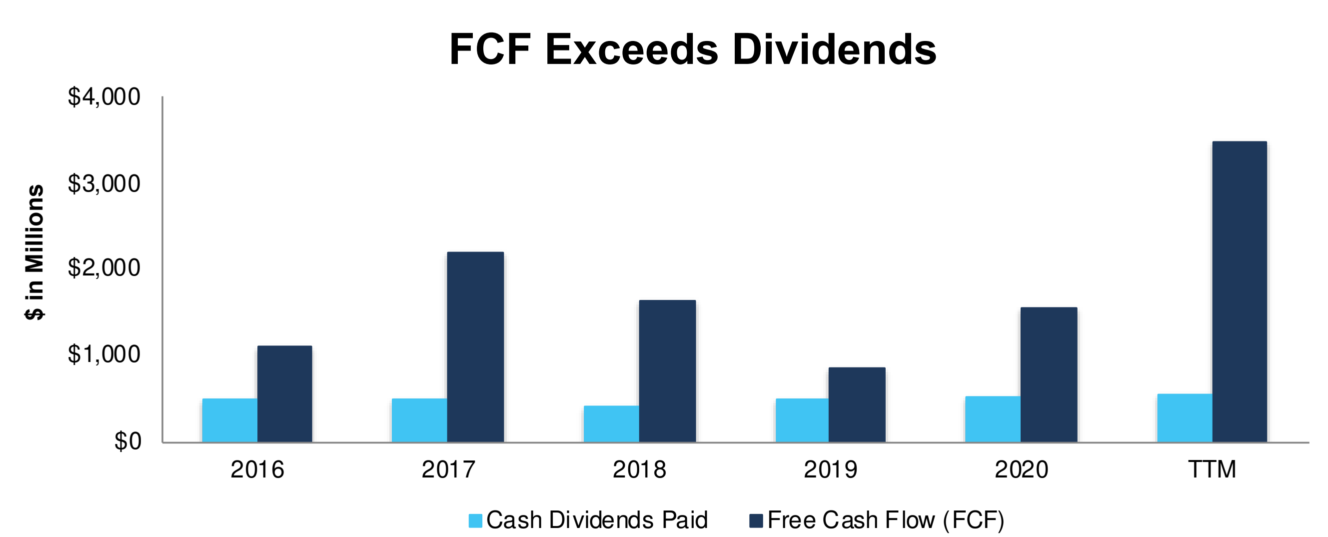
Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

Best Buy has increased its regular dividend for eight consecutive years and from $1.43/share in fiscal 2016 to $2.00/share in fiscal 2020, or 9% compounded annually. The current quarterly dividend, when annualized, equals $2.20/share and provides a 2.0% dividend yield.

More importantly, Best Buy's strong free cash flow (FCF) supports the firm's growing dividend payments. Best Buy generated a cumulative $7.3 billion (26% of current market cap) in FCF while paying $2.4 billion in dividends from fiscal 2016 to fiscal 2020, per Figure 2. Over the TTM, Best Buy generated $3.5 billion in free cash flow and paid $555 million in dividends.

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



Sources: New Constructs, LLC and company filings

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 a higher dividend. On the other hand, the dividend of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or even maintain its dividend because of inadequate free cash flow.

BBY Has Upside Potential

At its current price of $109/share BBY has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects Best Buy's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 10% compounded annually over the past two decades.

Even if Best Buy's NOPAT margin falls to 3.9% (equal to fiscal 2020 vs. 4.3% TTM), and the firm grows NOPAT by just 3% compounded annually for the next 10 years, the stock is worth $143/share today – a 31% upside. See the math behind the reverse DCF scenario. Add in Best Buy's 2.0% dividend yield and history of dividend growth, and it's clear why this stock is in December's Dividend Growth Stocks Model Portfolio.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Fact: we provide superior fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data and Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in Best Buy's 10-Qs and 10-K:

Income Statement: we made $296 million of adjustments with a net effect of removing $158 million in non-operating expenses (<1% of revenue). See all adjustments made to Best Buy's income statement here.

Balance Sheet: we made $3.0 billion of adjustments to calculate invested capital with a net increase of $1.8 billion. The most notable adjustment was $2.4 billion (31% of reported net assets) in asset write-downs. See all adjustments to Best Buy's balance sheet here.

Valuation: we made $8.3 billion of adjustments with a net effect of decreasing shareholder value by $1.4 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $3.4 billion in excess cash. This adjustment represents 12% of Best Buy's market value. See all adjustments to Best Buy's valuation here.

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Disclosure: David Trainer, Kyle Guske II, Alex Sword, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" can overcome these flaws and provides materially superior fundamental data.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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