Featured Stock in February's Dividend Growth Model Portfolio

21 new stocks make our Dividend Growth Stocks Model Portfolio this month, which was made available to members on February 25, 2021.

Recap From January's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (-0.2%) underperformed the S&P 500 (+2.6%) by 2.8% from January 28, 2021 through February 23, 2021. On a total return basis, the Model Portfolio (+0.1%) underperformed the S&P 500 (+2.6%) by 2.5% over the same time. The best performing stock was up 11%. Overall, six out of the 20 Dividend Growth Stocks outperformed the S&P 500 from January 28, 2021 through February 23, 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.

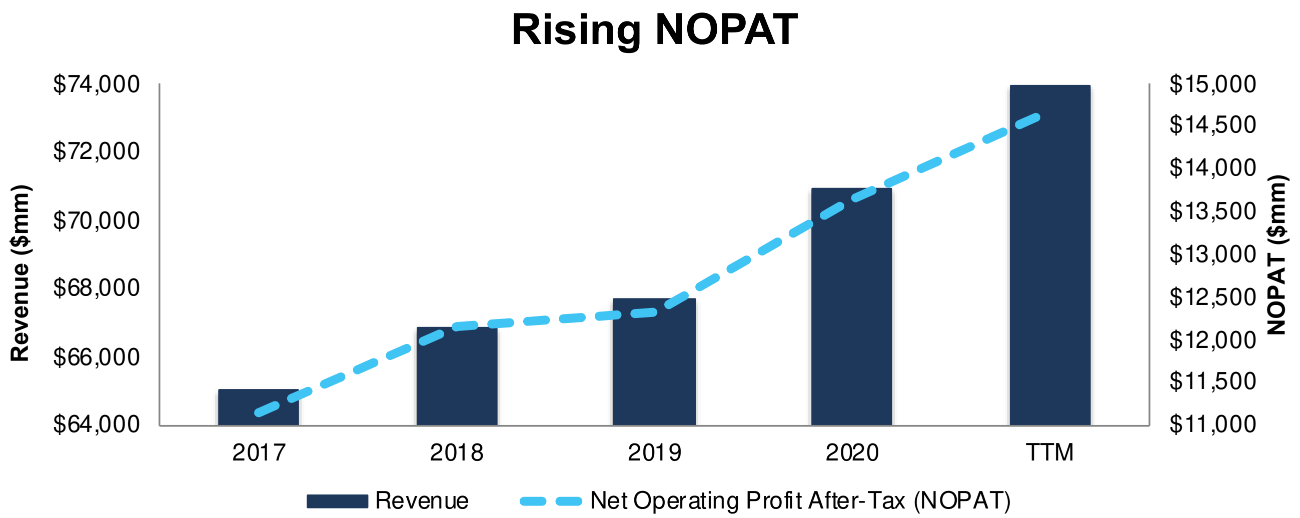
Featured Stock From February: Procter & Gamble Co. (PG: $124/share)

Procter & Gamble Co, (PG) is the featured stock from February's Dividend Growth Stocks Model Portfolio.

Procter & Gamble has grown revenue by 3% compounded annually and net operating profit after-tax (NOPAT) by 7% compounded annually since fiscal 2017. The firm's NOPAT margin has increased from 17% in fiscal 2017 to 20% over the trailing-twelve-months (TTM) while invested capital turns have improved from 0.57 to 0.63 over the same time. Rising NOPAT margin and invested capital turns drive Procter & Gamble's return on invested capital (ROIC) from 10% in fiscal 2017 to 13% TTM.

[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: Procter & Gamble NOPAT & Revenue Since Fiscal 2017



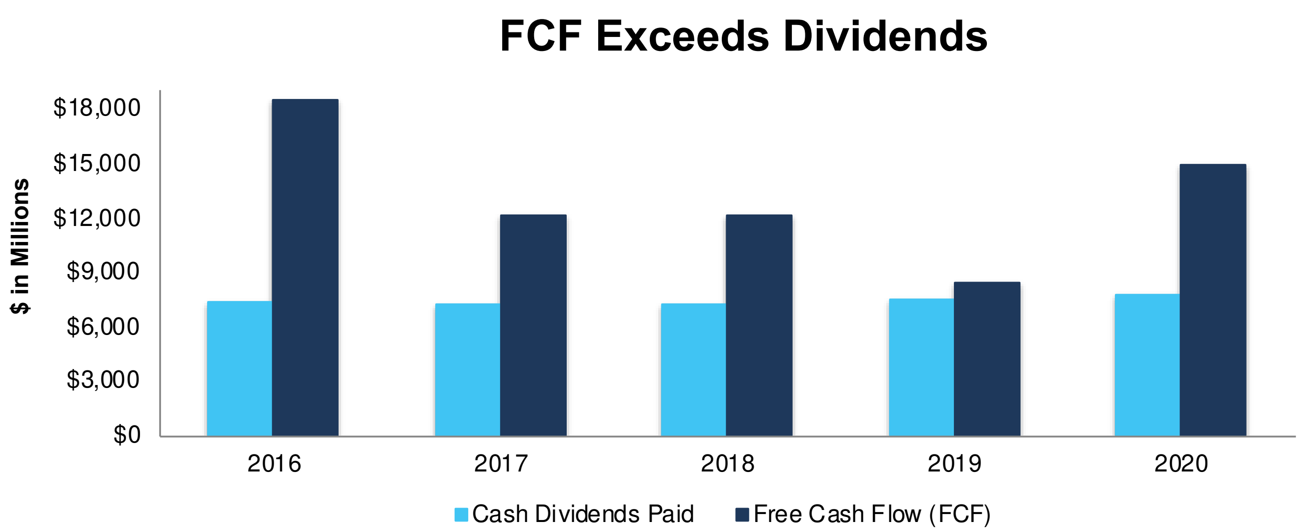
Sources: New Constructs, LLC and company filings

Steady Dividend Growth Supported by FCF

Procter & Gamble has increased its regular dividend in every year of our model (dates back 24 years) and from $2.66/share in fiscal 2016 to $3.03/share in fiscal 2020, or 3% compounded annually. The current quarterly dividend, when annualized, equals $3.16/share and provides a 2.6% dividend yield.

More importantly, Procter & Gamble's strong free cash flow (FCF) supports the firm's growing dividend payments. Procter & Gamble generated a cumulative $66 billion (22% of current market cap) in FCF while paying $37.3 billion in dividends from fiscal 2016 to fiscal 2020, per Figure 2. Over the TTM, Procter & Gamble generated $13.9 billion in free cash flow and paid $8 billion 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.

PG Has Upside Potential

At its current price of $124/share, PG has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects Procter & Gamble's NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 6% compounded annually over the past two decades.

Even if Procter & Gamble's NOPAT margin falls to 18% (five-year average vs. 20% TTM), and the firm grows NOPAT by just 2% compounded annually for the next decade, the stock is worth $183/share today – a 48% upside. See the math behind the reverse DCF scenario. Add in Procter & Gamble's 2.6% dividend yield and history of dividend growth, and it's clear why this stock is in February'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 Procter & Gamble's 10-Qs and 10-K:

Income Statement: we made $2.4 billion of adjustments with a net effect of removing $869 million in non-operating expenses (1% of revenue). See all adjustments made to Procter & Gamble's income statement here.

Balance Sheet: we made $58.3 billion of adjustments to calculate invested capital with a net increase of $28.7 billion. The most notable adjustment was $16.2 billion (18% of reported net assets) in other comprehensive income. See all adjustments to Procter & Gamble's balance sheet here.

Valuation: we made $62.1 billion of adjustments with a net effect of decreasing shareholder value by $41.1 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $10.5 billion in excess cash. This adjustment represents 3% of Procter & Gamble's market value. See all adjustments to Procter & Gamble's valuation here.

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Disclosure: David Trainer, Kyle Guske II, 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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