Featured Stock in February's Dividend Growth Model Portfolio

Twenty-two stocks were added to our Dividend Growth Stocks Model Portfolio this month, which was made available to members on February 25, 2022.

Recap From January's Picks

On a price return basis our Dividend Growth Stocks Model Portfolio (-2.0%) outperformed the S&P 500 (-2.2%) by 0.2%, and on a total return basis the Model Portfolio (-1.9%) outperformed the S&P 500 (-2.2%) by 0.3%. The best performing stock was up 19%. Overall, 9 out of the 17 Dividend Growth Stocks outperformed the S&P 500 from January 27, 2022 through February 23, 2022.

Buy the Dividend Growth Stocks Model Portfolio

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.

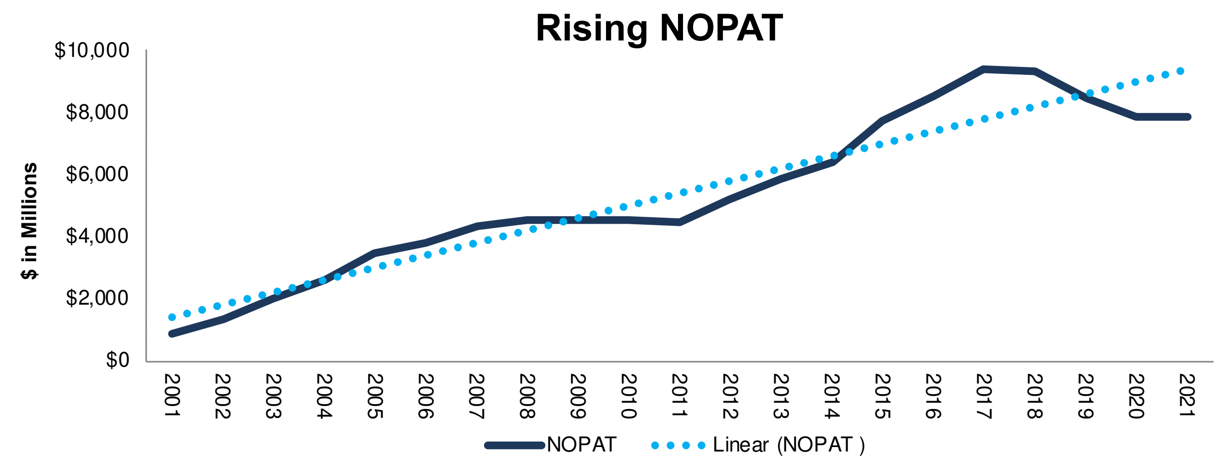
More reliable and proprietary fundamental data, proven in The Journal of Financial Economics, drives our research and provides investors with a new source of alpha. Our proprietary Robo-Analyst technology[1] scales our forensic accounting expertise (featured in Barron's)[2] to produce an unrivaled database of fundamental data.

Featured Stock From February: Amgen Inc. (AMGN: $225/share)

Amgen Inc. (AMGN) is the featured stock from February's Dividend Growth Stocks Model Portfolio. We made Amgen a Long Idea in May 2017. Since then, the stock is up 38% while the S&P 500 is up 79%. Despite its underperformance, the stock still offers an attractive risk/reward. Our most recent report on Amgen is here.

Amgen has grown revenue by 10% compounded annually and net operating profit after-tax (NOPAT) by 11% compounded annually over the past two decades. More recently, the company's NOPAT grew 6% compounded annually over the past decade. Amgen's NOPAT margin improved from 29% in 2011 to 30% in 2021, while the company's return on invested capital (ROIC) from 15.8% in 2011 to 16.4% in 2021.

Figure 1: Amgen's NOPAT & Revenue Since 2001



Sources: New Constructs, LLC and company filings

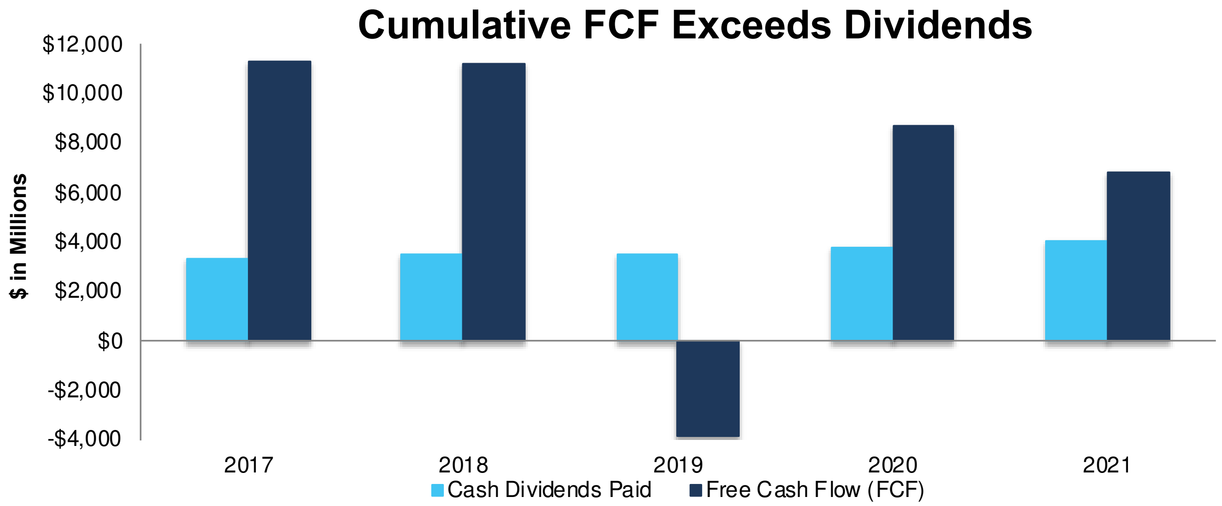
[1] Harvard Business School features our research automation technology in the case Disrupting Fundamental Analysis with Robo-Analysts.
[2] See how our models and financial ratios are superior to Bloomberg and Capital IQ's (SPGI) analytics in the detailed appendix of this paper.

FCF Exceeds Dividends by Wide Margin

Amgen has increased its dividend each year since 2011. The company increased its regular dividend from $4.60/share in 2017 to $7.04/share in 2021, or 11% compounded annually. The current quarterly dividend, when annualized, equals $7.76/share and provides a 3.4% dividend yield.

More importantly, Amgen's strong free cash flow (FCF) exceeds the company's growing dividend payments. Amgen's cumulative $34.2 billion (27% of current market cap) in FCF is nearly 2x the $18.2 billion in dividends paid out from 2017 – 2021, per Figure 2. Figure 2 also shows that Amgen's FCF significantly exceeded its dividend payments in four of the past five years.

Figure 2: Free Cash Flow vs. Regular Dividend Payments



Sources: New Constructs, LLC and company filings

Companies with FCF well above dividend payments provide higher quality dividend growth opportunities because we know the company 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.

Amgen Has Upside Potential

At its current price of $225/share, AMGN has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means the market expects Amgen's NOPAT to permanently decline by 30%. This expectation seems overly pessimistic for a company that has grown NOPAT by 6% compounded annually over the past decade.

Even if Amgen maintains 2021 NOPAT margins of 30% (compared to five-year average of 36%) and the company grows NOPAT by <1% compounded annually for the next decade, the stock is worth $319/share today – a 42% upside. See the math behind the reverse DCF scenario.

Should the company grow NOPAT more in line with historical growth rates, the stock has even more upside. Add in Amgen's 3.4% 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

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

Income Statement: we made $3.5 billion in adjustments with a net effect of removing $2.0 billion in non-operating expenses (11% of revenue). Clients can see all adjustments made to Amgen's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $20.1 billion of adjustments to calculate invested capital with a net decrease of $1.6 billion. The most notable adjustment was $7.4 billion (15% of reported net assets) in asset write-downs. Clients can see all adjustments made to Amgen's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $46.3 billion in adjustments with a net effect of decreasing shareholder value by $31.2 billion. Other than total debt, the most notable adjustment to shareholder value was $7.5 billion in excess cash. This adjustment represents 6% of Amgen's market value. Clients can see all adjustments to Amgen's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

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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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