Featured Stock in April's Safest Dividend Yields Model Portfolio

Seven new stocks make our Safest Dividend Yields Model Portfolio this month, which was made available to members on April 21, 2022.

Recap from March's Picks

On a price return basis, our Safest Dividend Yields Model Portfolio (+2.5%) outperformed the S&P 500 (+0.3%) by 2.2% from March 23, 2022 through April 19, 2022. On a total return basis, the Model Portfolio (+2.7%) outperformed the S&P 500 (+0.3%) by 2.4% over the same time. The best performing large cap stock was up 13% and the best performing small cap stock was up 6%. Overall, 15 out of the 20 Safest Dividend Yield stocks outperformed their respective benchmarks (S&P 500 and Russell 2000) from March 23, 2022 through April 19, 2022.

More reliable & 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) across thousands of stocks[2] to produce an unrivaled database of fundamental data.

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.

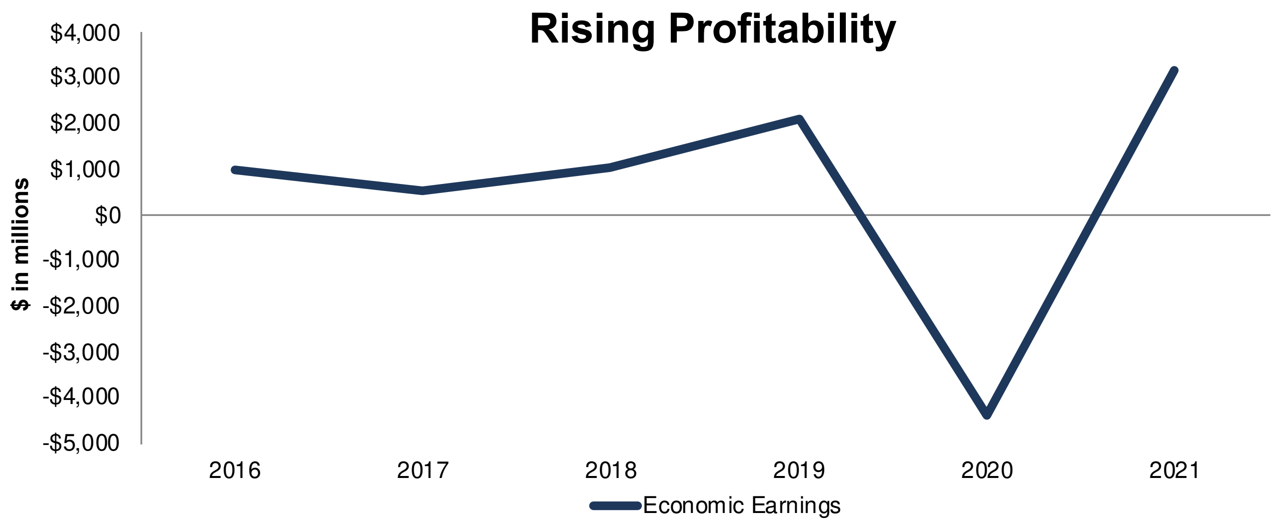
Featured Stock for April: Phillips 66 (PSX: $83/share)

Phillips 66 (PSX) is the featured stock in April's Safest Dividend Yields Model Portfolio. We made Phillips 66 a Long Idea in July 2020. Since then, the stock is up 24% vs. a 28% gain for the S&P 500. See our latest report on Phillips 66 here.

Phillips 66 has grown net operating profit after-tax (NOPAT) by 9% compounded annually since 2016. Phillips 66's NOPAT margin rose from 4.8% in 2016 to 5.5% in 2021, while invested capital turns improved from 1.8 to 2.0 over the same time. Rising NOPAT margins and invested capital turns drove the company's return on invested capital (ROIC) from 8% in 2016 to 11% in 2021. Despite a pandemic-driven dip in 2020, the company's economic earnings rose from $1.0 billion in 2016 to $3.2 billion in 2021, per Figure 1.

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

Figure 1: Phillips 66's Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

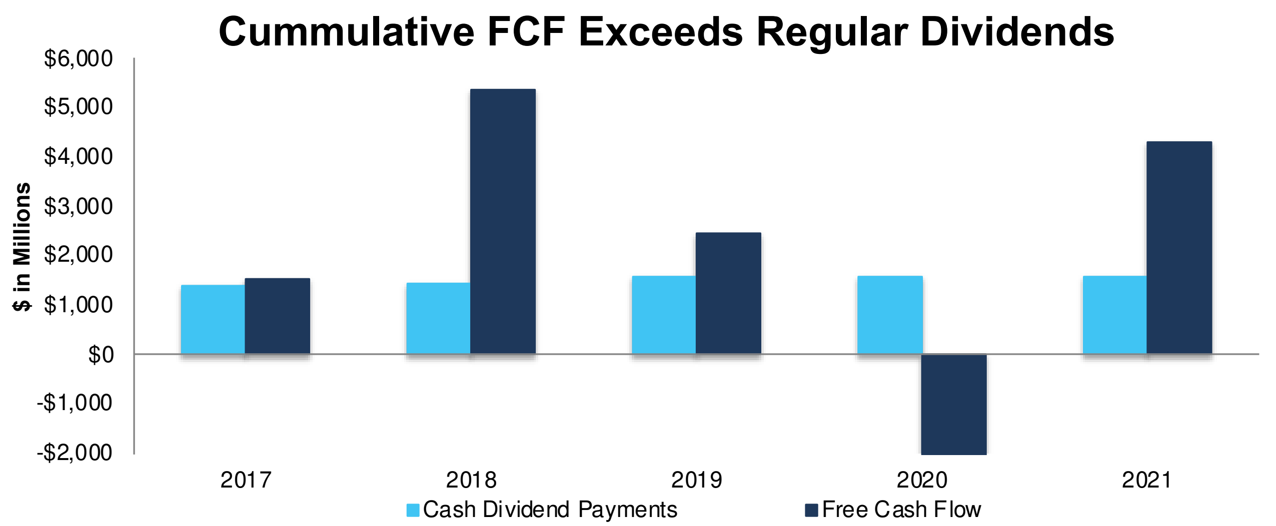
Free Cash Flow Supports Regular Dividend Payments

Phillips 66 has paid dividends in each year since 2012 and increased its regular dividend from $2.73/share in 2017 to $3.62/share in 2021. The current quarterly dividend, when annualized, provides a 4.5% dividend yield.

Since 2019, Phillips 66's cumulative FCF easily exceeds its regular dividend payments. From 2017 to 2021, Phillips 66 generated $11.7 billion (33% of current market cap) in FCF while paying $7.6 billion in dividends, per Figure 2.

Should the economic slowdown in 2022 worsen and the company's FCF turn negative as it did in 2020, the company's $3.1 billion of cash and cash equivalents provide an extra layer of protection for the dividend. For reference, the company paid $1.6 billion in dividends in 2021.

Figure 2: Phillips 66's FCF vs. Regular Dividends Since 2017



Sources: New Constructs, LLC and company filings

Companies with strong FCF provide higher quality dividend yields because the firm has the cash to support its dividend. Dividends from companies with low or negative FCF cannot be trusted as much because the company may not be able to sustain paying dividends.

Phillips 66 Is Undervalued

At its current price of $83/share, Phillips 66 has a price-to-economic book value (PEBV) ratio of 0.4. This ratio means the market expects Phillips 66's NOPAT to permanently decline by 60%. This expectation seems overly pessimistic given that Phillips 66 grew NOPAT by 9% compounded annually over the past five years.

Even if Phillips 66's NOPAT margin falls to 4% (below 2021 NOPAT margin of 5.5%) and the company's NOPAT falls by 1% compounded annually over the next decade, the stock is worth $135/share today – a 63% upside. See the math behind this reverse DCF scenario. Should the company grow NOPAT more in line with historical growth rates, the stock has even more upside.

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 Phillips 66's 10-K:

Income Statement: we made $6.0 billion in adjustments with a net effect of removing $4.8 billion in non-operating expenses (4% of revenue). Clients can see all adjustments made to Phillips 66's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $26.7 billion in adjustments to calculate invested capital with a net increase of $13.6 billion. The most notable adjustment was $10.9 billion (26% of reported net assets) in deferred tax assets. See all adjustments made to Phillips 66's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $26.1 billion in adjustments with a net effect of decreasing shareholder value by $25.8 billion. Apart from total debt, one of the most notable adjustments to shareholder value was $5.4 billion in net deferred tax liabilities, which include the deferred tax assets mentioned above. This adjustment represents 15% of Phillips 66's market value. See all adjustments to Phillips 66'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" enables investors to overcome these flaws and apply reliable fundamental data in their research.
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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