



Featured Stock in June's Dividend Growth Model Portfolio

Three stocks were added to our [Dividend Growth Stocks Model Portfolio](#) this month, which was made available to members on June 29, 2022.

Recap From May's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (-6.5%) underperformed the S&P 500 (-6.4%) by 0.1%, and on a total return basis, the Model Portfolio (-6.3%) underperformed the S&P 500 (-6.0%) by 0.3%. The best performing stock was up 9%. Overall, 17 out of the 30 Dividend Growth Stocks outperformed the S&P 500 from May 27, 2022 through June 27, 2022.

[Buy the Dividend Growth Stocks Model Portfolio](#)

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.

This report leverages our cutting-edge [Robo-Analyst technology](#) to deliver [proven-superior](#)¹ fundamental research and support more cost-effective fulfillment of the [fiduciary duty of care](#).

Featured Stock From June: Cummins Inc. (CMI: \$195/share)

Cummins Inc. (CMI) is the featured stock from June's Dividend Growth Stocks Model Portfolio. We made Cummins a Long Idea in [November 2018](#), and since then the stock is up 32% compared to a 41% gain for the S&P 500. CMI still offers excellent risk/reward, as detailed in our August 2021 update [here](#).

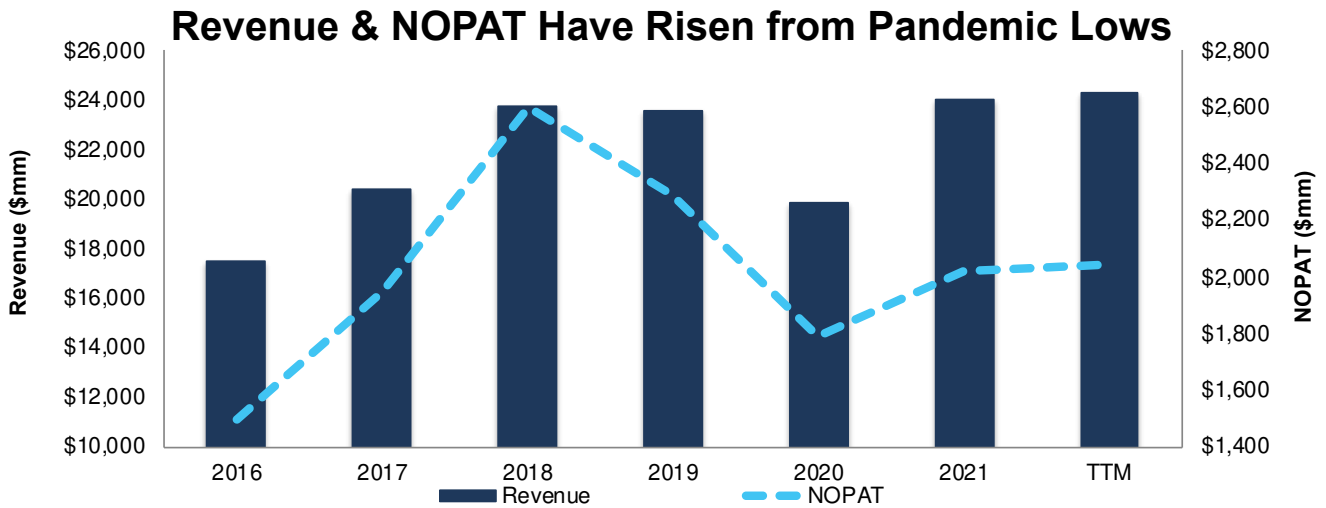
Cummins has grown revenue by 7% compounded annually and net operating profit after-tax (NOPAT) by 6% compounded annually over the past five years. Cummins' NOPAT margin fell from 8.6% in 2016 to 8.4% over the trailing twelve months (TTM), while [invested capital turns](#) improved from 1.4 to 1.5. Rising invested capital turns drove Cummins' return on invested capital (ROIC) from 12% in 2016 to 13% over the TTM. The company's [economic earnings](#), the true cash flows of the business, rose from \$793 million to \$1.2 billion over the same time.

Though pandemic-related disruptions contributed to a 22% year-over-year (YoY) decline in NOPAT in 2020, the company's TTM NOPAT is 14% above 2020 levels.

¹ Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).



Figure 1: Cummins' NOPAT & Revenue Since 2016



Sources: New Constructs, LLC and company filings

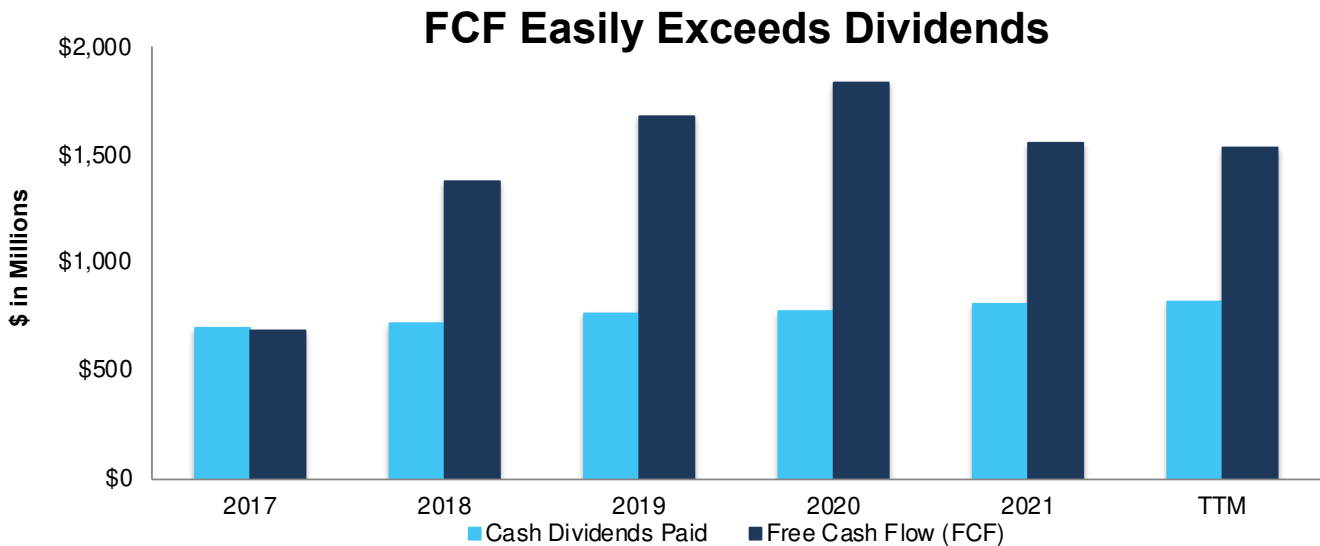
FCF Exceeds Dividends by Wide Margin

Cummins has increased its dividend in each of the past [13 years](#). The company increased its regular dividend from \$4.21/share in 2017 to \$5.60/share in 2021, or 7% compounded annually. The current quarterly dividend, when annualized, equals \$5.80/share, and provides a 3.0% dividend yield.

More importantly, Cummins' strong free cash flow (FCF) easily exceeds the company's growing dividend payments. From 2017 – 2021, Cummins' cumulative \$7.1 billion (26% of current market cap) in FCF is nearly twice the \$3.8 billion in dividends paid out, per Figure 2. Over the TTM, the company generated \$1.5 billion in FCF and paid out \$819 million in dividends.

Figure 2 also shows that Cummins' 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.

Cummins Has Upside Potential

At its current price of \$195/share, CMI has a price-to-economic book value ([PEBV](#)) ratio of 0.8. This ratio means the market expects Cummins' NOPAT to permanently decline by 20%. This expectation seems overly pessimistic for a company that has grown NOPAT by 6% compounded annually over the past five years.

If Cummins' NOPAT margin rises to 9% (three-year average vs. 8% TTM) and the company grows NOPAT by just 4% compounded annually for the next decade, the stock would be worth \$325+/share today – a 67% 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 Cummins' 3.0% dividend yield and history of dividend growth, and it's clear why this stock is in June'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 Cummins' 10-K and 10-Qs:

Income Statement: We made \$666 million in adjustments with a net effect of removing \$108 million in [non-operating income](#) (<1% of revenue). Clients can see all adjustments made to Cummins' income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: We made \$6.6 billion in adjustments to calculate invested capital with a net decrease of \$477 million. The most notable adjustment was \$1.6 billion (9% of reported net assets) in [other comprehensive income](#). Clients can see all adjustments made to Cummins' balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: We made \$8.4 billion in adjustments with a net effect of decreasing shareholder value by \$2.6 billion. The most notable adjustment to shareholder value was \$2.0 billion in [excess cash](#). This adjustment represents 7% of Cummins' market value. Clients can see all adjustments to Cummins' valuation on the GAAP Reconciliation tab on the Ratings page on our website.

This article originally published on [July 7, 2022](#).

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

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.



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](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs. Copyright New Constructs, LLC 2003 through the present date. All rights reserved.