Featured Stock in January's Dividend Growth Model Portfolio

Seven new stocks make our Dividend Growth Stocks Model Portfolio this month, which was made available to members on January 27, 2023.

Recap from December's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (5.3%) outperformed the S&P 500 (+4.4%) by 0.9% from December 29, 2022 through January 25, 2023. On a total return basis, the Model Portfolio (+5.4%) outperformed the S&P 500 (+4.4%) by 1.0% over the same time. The best performing stock was up 12%. Overall, 21 out of the 30 Dividend Growth Stocks outperformed the S&P 500 from December 29, 2022 through January 25, 2023.

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.

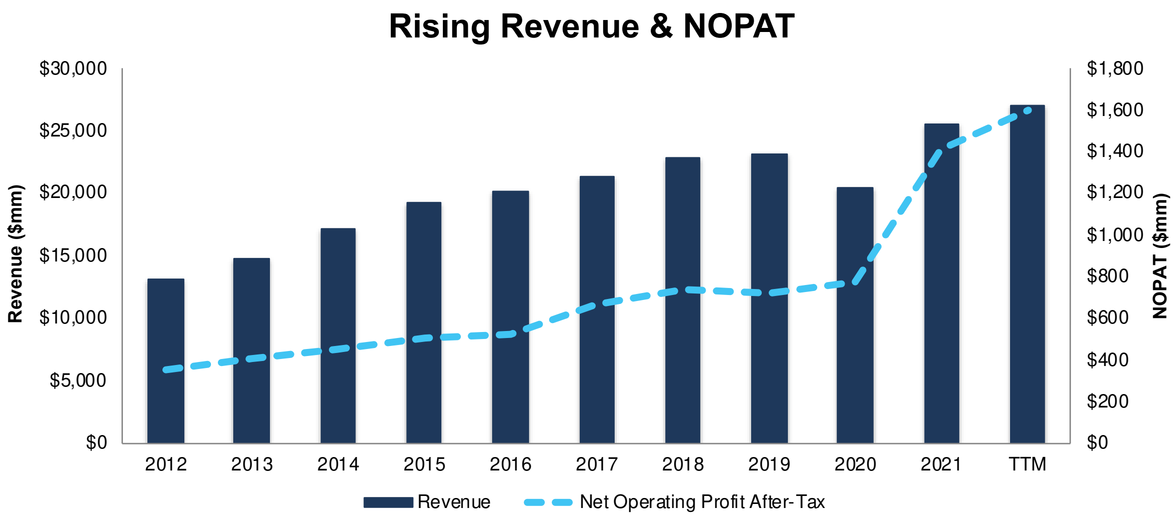
This Model Portfolio mimics an "All Cap Blend" style with a focus on dividend growth. Selected stocks earn an Attractive or Very Attractive rating, generate positive free cash flow (FCF) and economic earnings, offer a current dividend yield >1%, and have a 5+ year track record of consecutive dividend growth. This Model Portfolio is designed for investors who favor long-term capital appreciation over current income, but still appreciate the power of growing dividends.

January's Featured Stock: Penske Automotive Group (PAG: $128/share)

Penske Automotive Group (PAG) is the featured stock from January's Dividend Growth Stocks Model Portfolio.

Penske Automotive has grown revenue by 8% compounded annually and net operating profit after tax (NOPAT) by 17% compounded annually since 2012. The company's NOPAT margin rose from 3% in 2012 to 6% over the trailing-twelve-months (TTM), while return on invested capital (ROIC) rose from 5% to 12% over the same time.

Figure 1: Penske Automotive's Revenue and NOPAT Since 2012



Sources: New Constructs, LLC and company filings

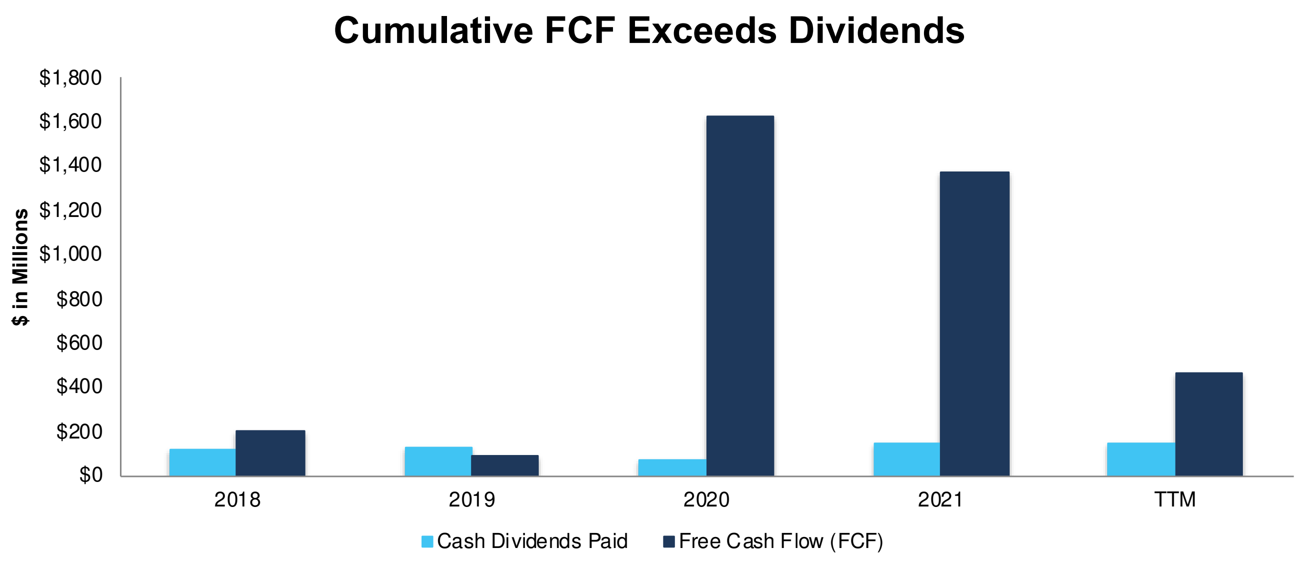
[1] Our research utilizes our Core Earnings, a more reliable measure of profits, as proven in Core Earnings: New Data & Evidence, written by professors at Harvard Business School (HBS) & MIT Sloan and published in The Journal of Financial Economics.

Steady Dividend Growth Supported by FCF

Penske Automotive has increased its dividend from $1.26/share in 2017 to $2.12/share over the TTM, or 12% compounded annually. The current quarterly dividend of $0.53/share, when annualized, equals $2.12/share and provides a 1.8% dividend yield.

More importantly, Penske Automotive's free cash flow (FCF) easily exceeds the company's growing dividend payments. From 2018-2021, Penske's cumulative $3.3 billion (19% of enterprise value) in FCF is 7x the $463 million paid out in dividends, per Figure 2. Over the TTM, Penske has generated $465 million in FCF and paid out $150 million in dividends.

Figure 2: Free Cash Flow Vs. Dividend Payments



Sources: New Constructs, LLC and company filings

Companies with FCF well above dividend payments provide higher-quality dividend growth opportunities. On the other hand, dividends that exceed FCF cannot be trusted to grow or even be maintained.

Penske Has Upside Potential

Despite Penske's profits being very strong recently, its current stock price implies a significant decline in profits. At its current price of $128/share, PAG has a price-to-economic book value (PEBV) ratio of 0.6. This means the market expects Penske Automotive's NOPAT to permanently decline by 40%. This expectation seems overly pessimistic for a company that has grown NOPAT by 17% compounded annually since 2012.

Even if Penske's NOPAT margin falls to 4% (equal to five-year average vs. 6% over the TTM) and the company grows revenue by just 4% compounded annually for the next 10 years, the stock would be worth $162/share today – a 27% upside. In this scenario, Penske's NOPAT would grow less than 1% compounded annually over the next decade. 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 Penske's 1.8% dividend yield and a history of dividend growth, and it's clear why this stock is in January's Dividend Growth Stocks Model Portfolio.

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

Below are specific adjustments we made based on Robo-Analyst findings in Penske Automotive's 10-Ks and 10-Qs:

Income Statement: We made $332 million in adjustments with a net effect of removing $221 million in non-operating expenses (1% of revenue). Clients can see all adjustments made to Penske Automotive's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: We made $4.7 billion in adjustments to calculate invested capital with a net increase of $4.7 billion. The most notable adjustment was $863 million (9% of reported net assets) in operating leases. Clients can see all adjustments made to Penske Automotive's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: We made $8.4 billion in adjustments, all of which decrease shareholder value. Apart from total debt, the most notable adjustment to shareholder value was $1.1 billion in deferred tax liabilities. This adjustment represents 12% of Penske Automotive's market value. Clients can see all adjustments to Penske Automotive'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 Italo Mendonça 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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