Featured Stock in February's Safest Dividend Yields Model Portfolio

Six new stocks made February's Safest Dividend Yields Model Portfolio, which was made available to members on February 23, 2023.

Recap from January's Picks

On a price return basis, our Safest Dividend Yields Model Portfolio (+6.4%) outperformed the S&P 500 (+2.7%) by 3.7% from January 19, 2023 through February 21, 2023. On a total return basis, the Model Portfolio (+7.0%) outperformed the S&P 500 (+2.7%) by 4.3% over the same time. The best performing large-cap stock was up 42%, and the best performing small-cap stock was up 22%. Overall, 10 out of the 20 Safest Dividend Yield stocks outperformed their respective benchmarks (S&P 500 and Russell 2000) from January 19, 2023 through February 21, 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 only includes stocks that earn an Attractive or Very Attractive rating, have positive free cash flow (FCF) 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 strong FCF supports the dividend. We think this portfolio provides a uniquely well-screened group of stocks that can help clients outperform.

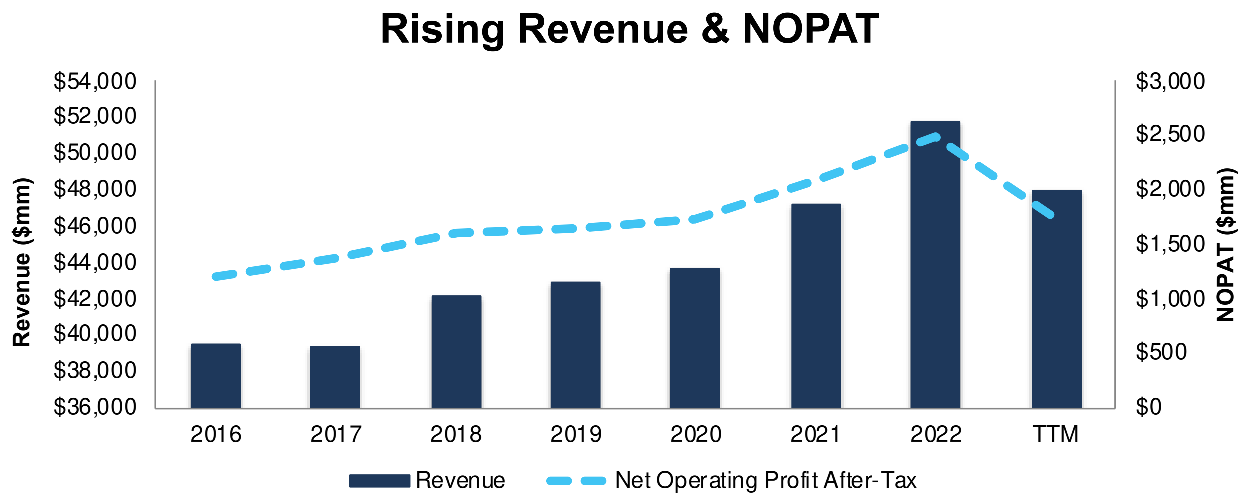
Featured Stock for February: Best Buy Co Inc (BBY: $81/share)

Best Buy Co Inc (BBY) is the featured stock in February's Safest Dividend Yields Model Portfolio.

Best Buy has grown revenue by 5% compounded annually and net operating profit after tax (NOPAT) by 13% compounded annually from fiscal 2016 to fiscal 2022. The company's NOPAT margin has risen from 3% in fiscal 2016 to 4% over the trailing-twelve-months (TTM), while invested capital turns improved from 4.0 to 5.9 over the same time. Rising NOPAT margins and invested capital turns drove return on invested capital (ROIC) from 12% in 2016 to 18% TTM. Note that many investors tend to overlook balance sheet analysis. As a result, they may miss Best Buy's substantially improved ROIC because they are not seeing the huge improvement in invested capital turns noted above.

[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: Best Buy's Revenue & NOPAT Since Fiscal 2016



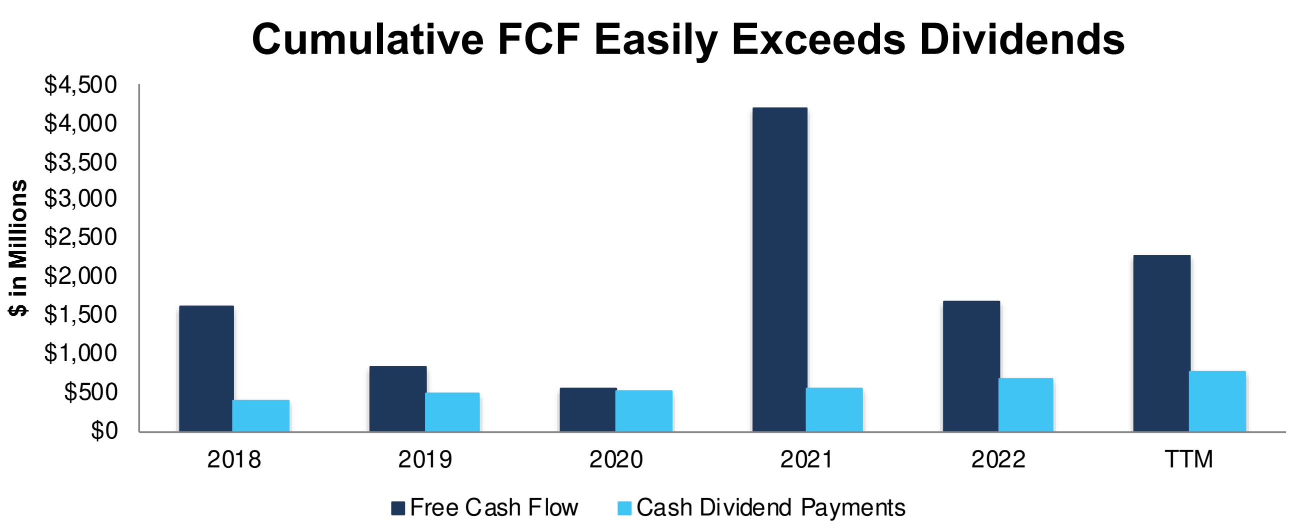
Sources: New Constructs, LLC and company filings

Free Cash Flow Supports Regular Dividend Payments

Best Buy has increased its regular dividend from $1.43/share in fiscal 2016 to $2.80/share in fiscal 2022. The current quarterly dividend, when annualized equals $3.52/share and provides a 4.4% dividend yield.

More importantly, Best Buy's free cash flow (FCF) easily exceeds its regular dividend payments. From fiscal 2018 to 2022, Best Buy generated $8.9 billion (41% of current enterprise value) in FCF while paying $2.7 billion in dividends. Over the TTM, Best Buy generated $2.3 billion in FCF and paid out $761 million in dividends. See Figure 2.

Figure 2: Best Buy's FCF vs. Regular Dividends Since Fiscal 2018



Sources: New Constructs, LLC and company filings

As Figure 2 shows, Best Buy's dividends are backed by a history of reliable cash flows. Dividends from companies with low or negative FCF are less dependable since the company may not be able to sustain paying dividends.

BBY Is Undervalued

At its current price of $81/share, Best Buy has a price-to-economic book value (PEBV) ratio of 1.0. This ratio means the market expects Best Buy's NOPAT to never grow higher than its current level. This expectation seems overly pessimistic given that Best Buy has grown NOPAT by 13% compounded annually since fiscal 2016 and 8% compounded annually since fiscal 2002.

Even if Best Buy's NOPAT margin falls to 3% (below its 2022 NOPAT margin of 5%) and revenue grows by just 3.5% compounded annually (below its 5% revenue CAGR since 2016) over the next decade, the stock would be worth $99+/share today – a 22% upside. In this scenario, Best Buy's NOPAT would grow 3% compounded annually from the TTM through fiscal 2032. For reference, NOPAT grew 13% compounded annually from fiscal 2016 to fiscal 2022. Should the company's NOPAT grow 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 Best Buy's 10-Ks and 10-Qs:

Income Statement: we made $358 million in adjustments with a net effect of removing $36 million in non-operating expenses (<1% of revenue). Clients can see all adjustments made to Best Buy's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $4.4 billion in adjustments to calculate invested capital with a net increase of $1.9 billion. The most notable adjustment was $2.4 billion (36% of reported net assets) in asset write-downs. See all adjustments made to Best Buy's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $3.8 billion in adjustments, with a net decrease of $3.8 billion decrease in value. Apart from total debt, one of the most notable adjustments to shareholder value was $58 million in operating leases. This adjustment represents less than 1% of Best Buy's market value. See all adjustments to Best Buy's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

This article was originally published on *March 3, 2023*.

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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