# Featured Stocks in March's Dividend Growth Model Portfolio

This report highlights last month's top performers and features a stock from the current portfolio. March's Dividend Growth Stocks Model Portfolio was made available to members on March 28, 2018.

**Recap from February's Picks**

Our Dividend Growth Stocks Model Portfolio outperformed the S&P 500 on a price return basis and performed in line on a total return basis last month. The Model Portfolio fell 2.1% on a price return basis and fell 2.0% on a total return basis. The S&P 500 fell 2.4% on a price return basis and fell 2.0% on a total return basis. The portfolio's best performing stock was Nu Skin Enterprises (NUS), which was up 5%. Overall, 16 out of the 30 Dividend Growth Stocks outperformed the S&P last month, and eight had positive returns.

The long-term success of our model portfolio strategies highlights the value of our Robo-Analyst technology[1], which scales our forensic accounting expertise (featured in Barron's) across thousands of stocks[2].

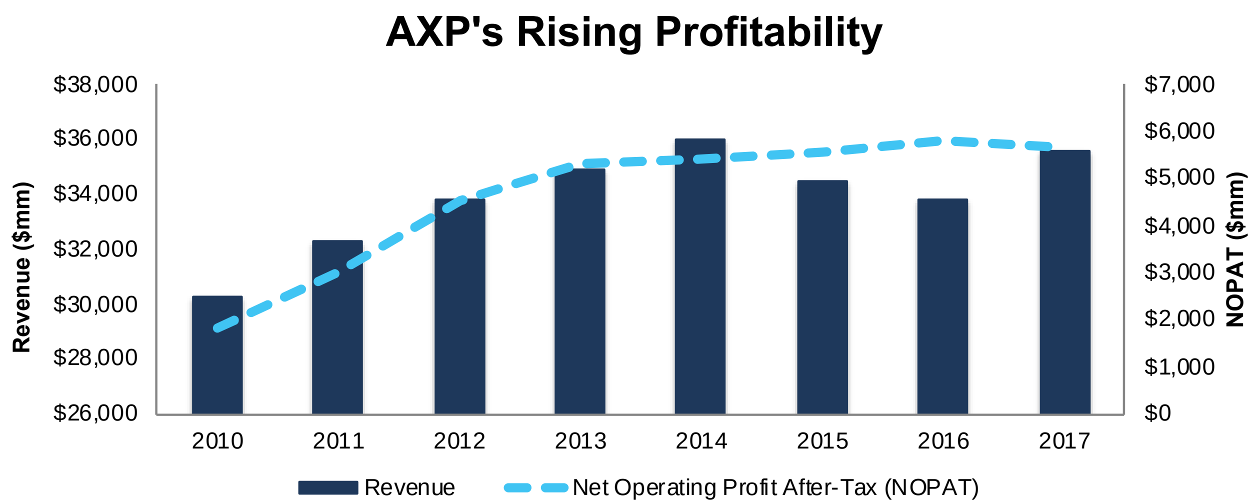
The methodology for this model portfolio mimics an All-Cap Blend style with a focus on dividend growth. Selected stocks earn an Attractive or Very Attractive rating, generate positive free cash flow (FCF) and economic earnings, offer a current dividend yield >1%, and have a 5+ year track record of consecutive 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.

**Featured Stock from March: American Express Company (AXP: $93/share)**

Credit card provider American Express Company (AXP) is the featured stock from March's Dividend Growth Stocks Model Portfolio. AXP was first featured in our January 2016 case study on how return on invested capital (ROIC) impacts stock valuation. Since then, the stock is up 52% while the S&P 500 is up 27%. Despite this outperformance, AXP remains undervalued.

Since 2010, AXP's revenue has grown 2% compounded annually while its after-tax profit (NOPAT) has grown 18% compounded annually. AXP's NOPAT margin has improved from 6% in 2010 to 16% in 2017 while its return on invested capital (ROIC) improved from 6% to 14%.

**Figure 1: AXP Revenue & NOPAT Since 2010**




Sources: New Constructs, LLC and company filings

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.

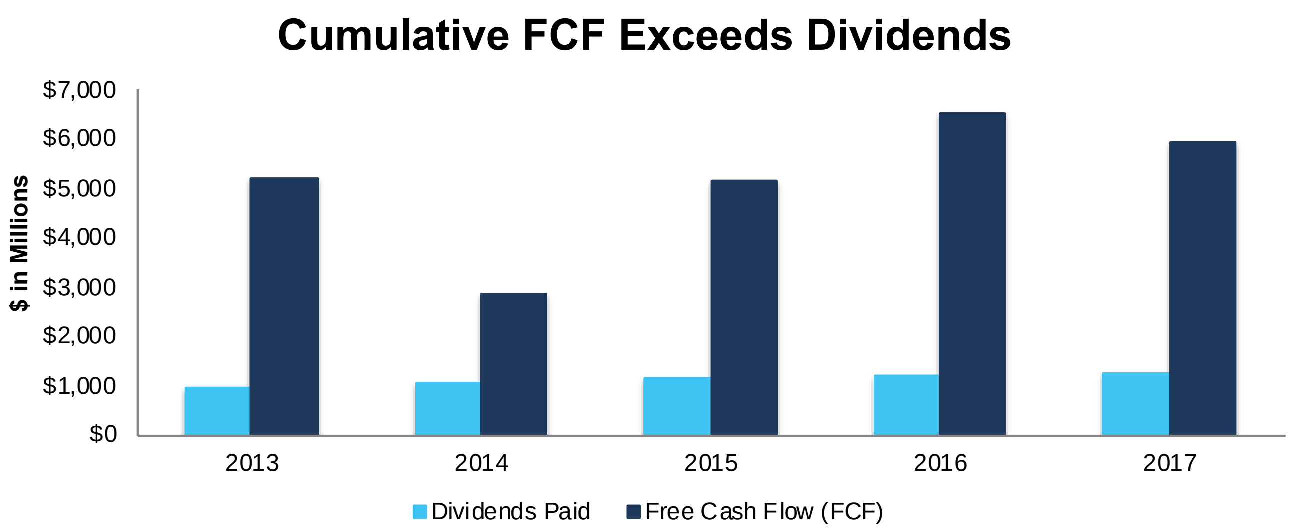
[2] Ernst & Young's recent white paper "Getting ROIC Right" proves the superiority of our holdings research and analytics.

### Steady Dividend Growth Supported by FCF

AXP has increased its annual dividend for six consecutive years. The current annualized dividend has grown from $0.89/share in 2013 to $1.34/share in 2017, or 11% compounded annually. Positive FCF has fueled dividend growth in the past and should continue to do so in the future. From 2013-2017, AXP generated cumulative FCF of $25.6 billion (32% of market cap) and paid out cumulative dividends of $5.6 billion.

Companies with FCF well in excess of dividend payments provide higher quality dividend growth opportunities because we know the firm generates the cash to support the current dividend as well as a higher dividend. On the flip side, the dividend growth trajectory of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or sustain its dividend because of inadequate free cash flow.

**Figure 2: Free Cash Flow (FCF) vs. Regular Dividend Payments**




Sources: New Constructs, LLC and company filings

### AXP Remains Undervalued

At its current price of $93/share, AXP has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects AXP's NOPAT to permanently decline by 10%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 6% compounded annually since 1998 and 18% compounded annually since 2010.

If AXP can maintain 2017 NOPAT margins (16%) and grow NOPAT by 3% compounded annually over the next decade, the stock is worth $127/share today – a 47% upside. Add in American Express' 1.5% dividend yield and history of dividend growth, and it's clear why this stock is in March's Dividend Growth Stocks Model Portfolio.

### Auditable Impact of Footnotes & Forensic Accounting Adjustments

Our Robo-Analyst technology enables us to perform forensic accounting with scale and provide the research needed to fulfill fiduciary duties. In order to derive the true recurring cash flows, an accurate invested capital, and a real shareholder value, we made the following adjustments to American Express' 2017 10-K:

Income Statement: we made $3 billion of adjustments with a net effect of removing $3 billion in non-operating expense (9% of revenue). We removed $3 billion related to non-operating expenses and there were no adjustments related to non-operating income. See all adjustments made to AXP's income statement here.

Balance Sheet: we made $7.1 billion of adjustments to calculate invested capital with a net increase of $3.8 billion. The most notable adjustment was $2.4 billion (7% of reported net assets) related to other comprehensive income. See all adjustments to AXP's balance sheet here.

Valuation: we made $1.7 billion of adjustments with a net effect of decreasing shareholder value by $1.7 billion. There were no adjustments that increased shareholder value. The largest adjustment to shareholder value was

$872 million in off-balance sheet operating leases. This lease adjustment represents 1% of AXP's market value. Despite the decrease in shareholder value, AXP remains undervalued.

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

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### *Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale*

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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