



## Featured Stocks in July's Dividend Growth Model Portfolio

This report highlights last month's top performers and features a stock from the current portfolio. July's [Dividend Growth Stocks Model Portfolio](#) was made available to members on July 27, 2018.

### Recap from June's Picks

Our Dividend Growth Stocks Model Portfolio underperformed the S&P 500 last month. The Model Portfolio rose 3.3% on a price return basis and 3.5% on a total return basis. The S&P 500 rose 5.4% on a price return and total return basis. The portfolio's best performing stock was Ituran Location and Control Ltd. (ITRN), which was up 16%. Overall, seven out of the 30 Dividend Growth Stocks outperformed the S&P last month, and 26 had positive returns.

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

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.

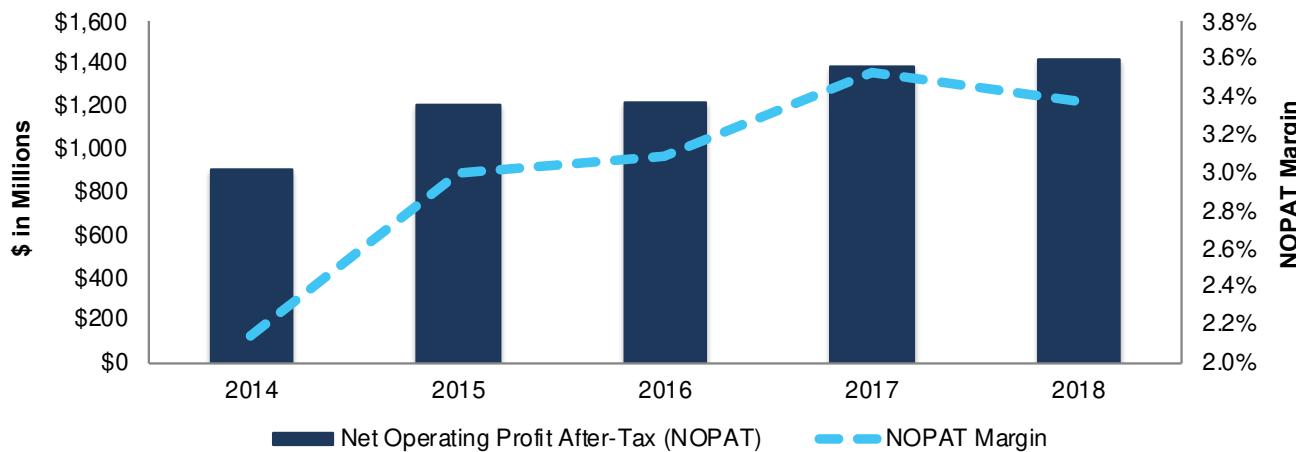
### Featured Stock from July: Best Buy Co. (BBY: \$74/share)

Best Buy Co. (BBY), a consumer electronics retailer, is the featured stock from July's Dividend Growth Stocks Model Portfolio. BBY was also a featured Long Idea in [April 2018](#) and is currently in our [Focus List – Long](#) Model Portfolio.

Since fiscal 2014, BBY has grown after-tax operating profit ([NOPAT](#)) by 12% compounded annually. BBY's NOPAT margin has improved from 2.1% in fiscal 2014 to 3.4% in fiscal 2018 while its return on invested capital ([ROIC](#)) improved from 7% to 15%.

Figure 1: BBY's NOPAT and Margin Since Fiscal 2014

### BBY's Improving Profitability



Sources: New Constructs, LLC and company filings

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

<sup>2</sup> Ernst & Young's recent white paper "[Getting ROIC Right](#)" proves the superiority of our holdings research and analytics.



### **Steady Dividend Growth Supported by FCF**

Best Buy has increased its annual dividend in each of the last five years and eight times within the last decade. BBY's annual dividend has grown from \$0.68/share in fiscal 2014 to \$1.36/share in fiscal 2018, or 19% compounded annually. The current dividend equates to a 2.4% dividend yield. Best of all, Best Buy generates the necessary cash flow to continue paying its dividend. Over the past five years, BBY has generated a cumulative \$12.5 billion (61% of market cap) in free cash flow while paying \$1.9 billion in dividends.

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.

### **BBY Provides Significant Upside Potential**

As we noted in our Long Idea, BBY is well positioned to excel in a hypothetical Amazon-dominated retail world yet the stock is priced as if the company has no potential for future growth. This disconnect leaves shares significantly undervalued. At its current of \$74/share, BBY has a price-to-economic book value ([PEBV](#)) ratio of 1.0. This ratio means the market expects BBY's NOPAT to remain flat and never grow from current levels. This expectation seems overly pessimistic for a firm that has grown NOPAT by 12% compounded annually since 1998.

If BBY maintains current margins (3%) and grows NOPAT by just 3% compounded annually over the next decade, the stock is worth \$89/share today – a 20% upside. [See the math behind this dynamic DCF scenario](#). Add in Best Buy's 2.4% dividend yield and history of dividend growth, and it's clear why this stock is in July's Dividend Growth Stocks Model Portfolio.

### **Critical Details Found in Financial Filings By Our [Robo-Analyst Technology](#)**

As investors [focus more](#) on fundamental research, research automation technology is needed to analyze all the critical financial [details in financial filings](#). Below are specifics on the adjustments we make based on Robo-Analyst findings in Best Buy's 2018 10-K:

Income Statement: we made \$523 million of adjustments, with a net effect of removing \$423 million in non-operating expense (1% of revenue). We removed \$50 million in [non-operating income](#) and \$473 million in [non-operating expenses](#). You can see all the adjustments made to BBY's income statement [here](#).

Balance Sheet: we made \$7.2 billion of adjustments to calculate invested capital with a net increase of \$4 billion. The most notable adjustment was \$2.6 billion in [operating leases](#). This adjustment represented 50% of reported net assets. You can see all the adjustments made to BBY's balance sheet [here](#).

Valuation: we made \$4.6 billion of adjustments with a net effect of decreasing shareholder value by \$3.5 billion. Apart from \$4 billion in [total debt](#), which includes the \$2.6 billion in [operating leases](#) noted above, the largest adjustment to shareholder value was \$496 million in [excess cash](#). This cash adjustment represents 2% of BBY's market cap. Despite the decrease in shareholder value, BBY remains undervalued.

*This article originally published on [August 1, 2018](#).*

*Disclosure: David Trainer, Kyle Guske II, and Sam McBride 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.*



## New Constructs® - Research to Fulfill the Fiduciary Duty of Care

---

Ratings & screeners on 3000 stocks, 450 ETFs and 7000 mutual funds help you make prudent investment decisions.

New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

### **To fulfill the Duty of Care, research should be:**

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

### **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.

## 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 15 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.