



## Featured Stock in January's Dividend Growth Model Portfolio

11 new stocks make our [Dividend Growth Stocks Model Portfolio](#) this month, which was made available to members on January 30, 2019.

Get the best fundamental research

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>.

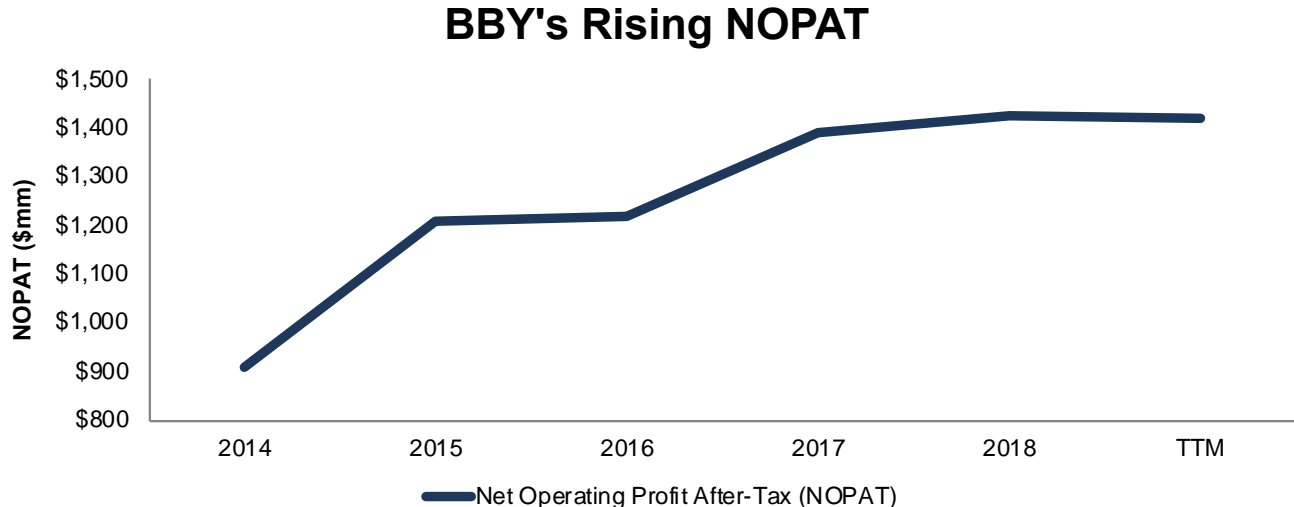
The methodology for this model portfolio mimics an All-Cap Blend style with a focus on dividend growth. Selected stocks earn an [Attractive or Very Attractive rating](#), generate positive free cash flow (FCF) and [economic earnings](#), offer a current dividend yield >1%, and have a 5+ year track record 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 January: Best Buy Co. (BBY: \$59/share)

Best Buy Co. (BBY) is the featured stock from January's Dividend Growth Stocks Model Portfolio. We also featured BBY as a Long Idea in [April 2018](#).

Since fiscal 2014, BBY has grown after-tax operating profit (NOPAT) by 12% compounded annually. BBY's NOPAT margin has improved from 2% in fiscal 2014 to 3% over the last twelve months (TTM) while its return on invested capital (ROIC) improved from 7% to 15% over the same time.

Figure 1: BBY's Profits On the Rise Since Fiscal 2014



Sources: New Constructs, LLC and company filings

### Steady Dividend Growth Supported by FCF

Best Buy has increased its annual dividend in each of the last six years and eight times within the last decade. BBY's annual dividend has grown from \$0.68/share in fiscal 2014 to \$1.80/share TTM, or 21% compounded annually. Positive [free cash flow](#) fueled dividend growth in the past and should continue to do so in the future.

<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](#)" demonstrates the superiority of our stock research and analytics.

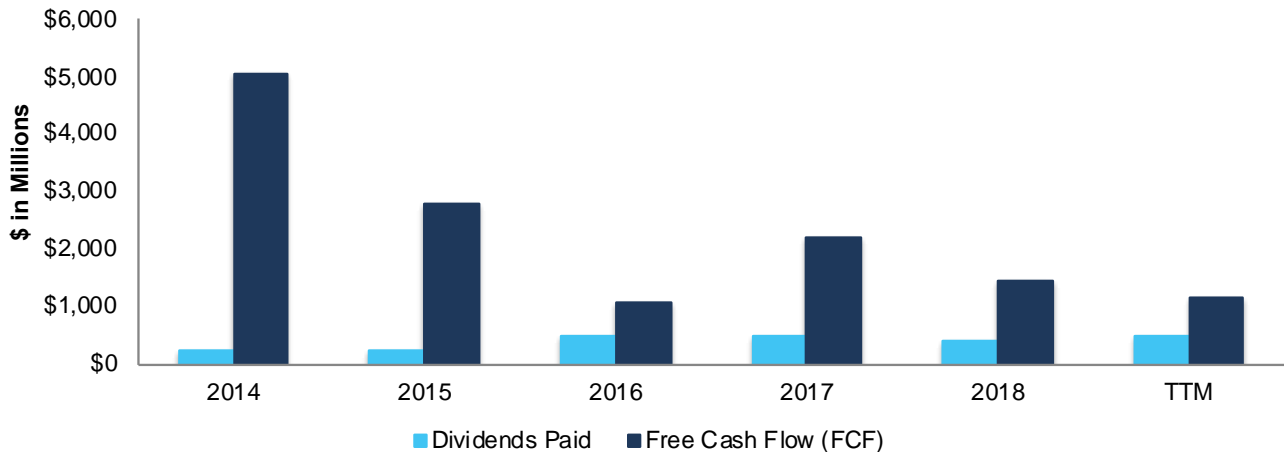


From fiscal 2014 to fiscal 2018, BBY generated cumulative FCF of \$12.5 billion (78% of market cap) while paying \$1.9 billion in dividends. Over the TTM period, BBY has generated \$1.2 billion in FCF and paid \$475 million in dividends.

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 of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or even stay the same because of inadequate free cash flow.

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

### FCF Greatly Exceeds Dividends



Sources: New Constructs, LLC and company filings

#### BBY Holds Significant Upside Potential

At its current price of \$59/share, BBY has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects BBY's NOPAT to permanently decline by 10%. This expectation seems overly pessimistic for a firm that has grown NOPAT by 12% compounded annually since fiscal 2014.

If BBY can maintain current NOPAT margins (3% TTM) and grow NOPAT by just 2% compounded annually for the next decade, the stock is worth \$77/share today – a 31% upside. [Click here to see the math behind this dynamic DCF scenario.](#) Add in BBY's 3% dividend yield and 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](#)

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 fiscal 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). See all 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 \$4.0 billion. The most notable adjustment was \$2.6 billion (50% of reported net assets) in [off balance sheet operating leases](#). See all adjustments to BBY's balance sheet [here](#).

Valuation: we made \$4.1 billion of adjustments with a net effect of decreasing shareholder value by \$3.9 billion. Apart from \$4 billion in [total debt](#), which includes the operating leases noted above, the largest adjustment to shareholder value was \$72 million in [deferred compensation](#). This adjustment represents <1% of BBY's market value. Despite the net decrease in shareholder value, BBY remains undervalued.

*This article originally published on [February 8, 2019](#).*



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

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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:***

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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.



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