



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

Nine new stocks make our [Dividend Growth Stocks Model Portfolio](#) this month, which was made available to members on October 29, 2020.

### Recap From September's Picks

On a price return basis, our Dividend Growth Stocks Model Portfolio (+3.3%) outperformed the S&P 500 (+1.0%) by 2.3% from September 30, 2020 through October 27, 2020. On a total return basis, the Model Portfolio (+3.4%) outperformed the S&P 500 (+1.0%) by 2.4% over the same time. The best performing stock was up 58%. Overall, 13 out of the 30 Dividend Growth Stocks outperformed the S&P 500 from September 30, 2020 through October 27, 2020.

[Learn more about the best fundamental research](#)

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)." 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 October: Anthem, Inc. (ANTM: \$328/share)

Anthem, Inc. (ANTM) is the featured stock from October's Dividend Growth Stocks Model Portfolio.

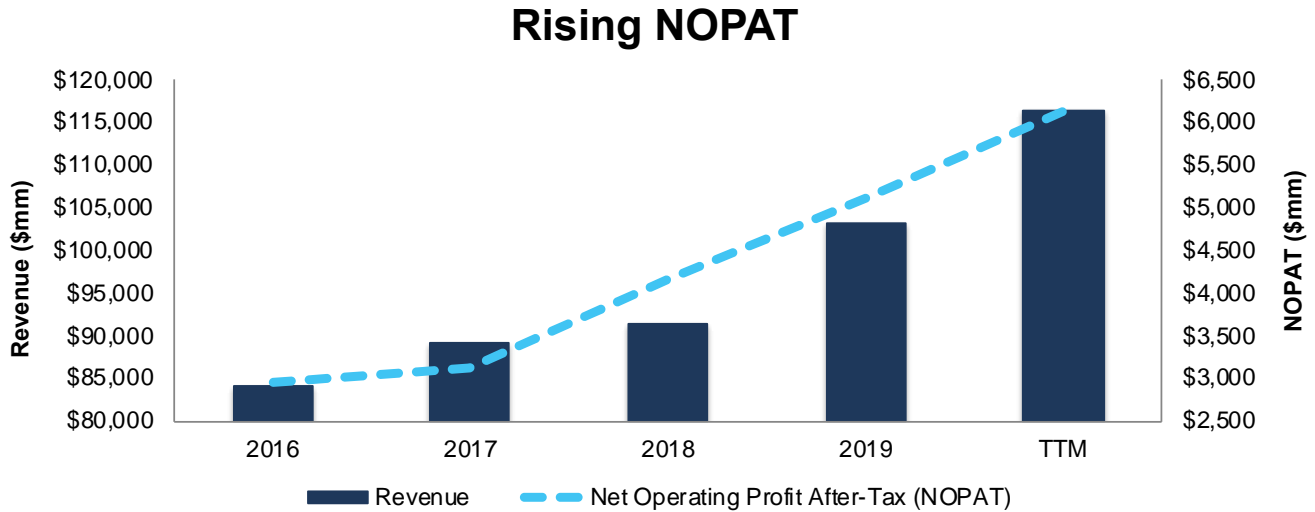
Anthem has grown revenue and net operating profit after-tax ([NOPAT](#)) by 5% compounded annually over the past decade. More recently, Anthem has grown NOPAT by 20% compounded annually over the past three years. The firm's NOPAT margin has increased from 4% in 2016 to 5% TTM, while [invested capital turns](#) improved from 1.8 to 2.0 over the same time. Rising margins and invested capital turns drive return on invested capital ([ROIC](#)) from 6% in 2016 to 10% TTM.

<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> Compare our analytics on a mega cap company to Bloomberg and Capital IQ's (SPGI) analytics in the [detailed appendix of this paper](#).



Figure 1: Anthem's Revenue & NOPAT Since 2016



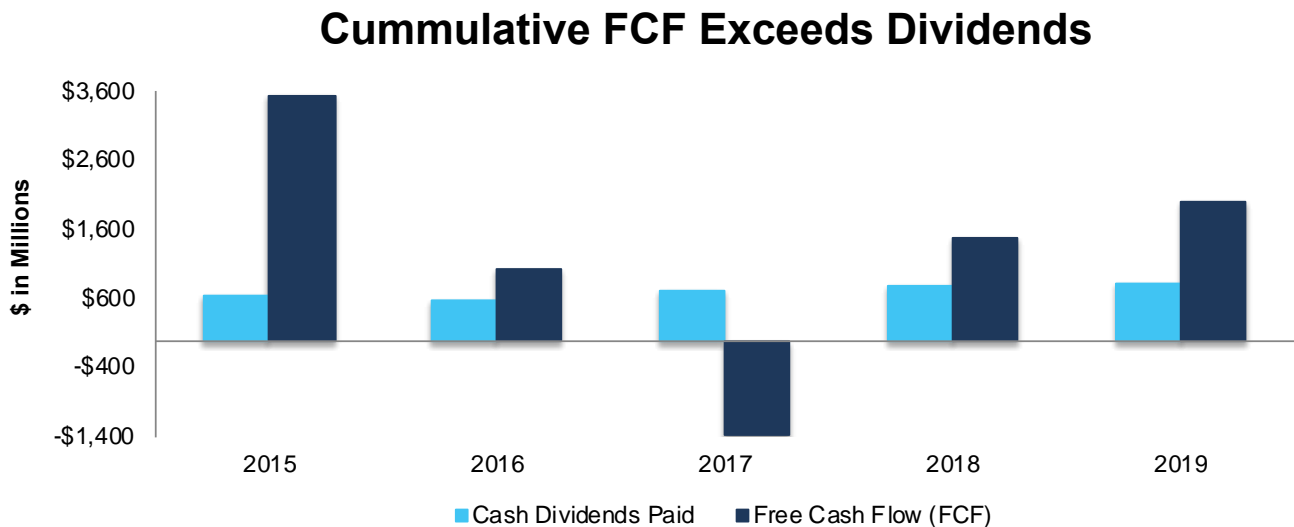
Sources: New Constructs, LLC and company filings

#### Steady Dividend Growth Supported by FCF

Anthem has increased its dividend for nine consecutive years and from \$2.50/share in 2015 to \$3.20/share in 2019, or 6% compounded annually. The current quarterly dividend, when annualized, equals \$3.80/share and provides a 1.2% dividend yield.

More importantly, Anthem's strong free cash flow (FCF) supports the firm's dividend payment. Anthem generated \$6.7 billion (9% of current market cap) in FCF while paying \$3.5 billion in dividends from 2015 to 2019, per Figure 2. Over the TTM, Anthem generated \$2.4 billion in FCF and paid just \$922 million in dividends.

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



Sources: New Constructs, LLC and company filings

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 a higher dividend. On the other hand, the dividend of a company where FCF falls short of the dividend payment over time cannot be trusted to grow or even maintain its dividend because of inadequate free cash flow.



### ANTM Has Upside Potential

At its current price of \$328/share, ANTM has a price-to-economic book value ([PEBV](#)) ratio of 0.9. This ratio means the market expects Anthem's NOPAT to permanently decline by 10%. This expectation seems overly pessimistic given that Anthem grew NOPAT by 10% compounded annually over the past five years and 5% compounded annually over the past decade.

Even if Anthem's NOPAT margin falls to 4% (three-year average vs. 5% TTM) and the firm grows NOPAT by just 4% compounded annually for the next decade, the stock is worth \$376/share today – a 15% upside. [See the math behind this reverse DCF scenario.](#)

### 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](#) as shown in the Harvard Business School and MIT Sloan paper, "[Core Earnings: New Data and Evidence](#)".

Below are specifics on the adjustments we make based on Robo-Analyst findings in Anthem's 10-Q's and 10-K:

Income Statement: we made \$1.2 billion of adjustments with a net effect of removing \$316 million in [non-operating expenses](#) (<1% of revenue). See all adjustments made to Anthem's income statement [here](#).

Balance Sheet: we made \$6 billion of adjustments to calculate invested capital with a net increase of \$1.7 billion. The most notable adjustment was \$1.3 billion (2% of reported net assets) in [other comprehensive income](#). See all adjustments to Anthem's balance sheet [here](#).

Valuation: we made \$26.9 billion of adjustments with a net effect of decreasing shareholder value by \$26.8 billion. Apart from [total debt](#), one of the most notable adjustments to shareholder value was \$2.4 billion in [net deferred tax liabilities](#). This adjustment represents 3% of Anthem's market value. See all adjustments to Anthem's valuation [here](#).

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

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## Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

[HBS & MIT Sloan research](#) reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies ([featured by Harvard Business School](#)), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, [Core Earnings: New Data and Evidence](#), shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This [paper](#) compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

**Learn [more](#).**

Quotes from HBS & MIT Sloan professors on our research:

### **Get better research:**

*“...the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications.” – page 20*

### **Pick better stocks:**

*“Trading strategies that exploit cross-sectional differences in firms’ transitory earnings produce abnormal returns of 7-to-10% per year.” – Abstract*

### **Avoid losses from using other firms’ data:**

*“...many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat...” – page 14*

### **Build better models:**

*“Core Earnings [calculated using New Constructs’ novel dataset] provides predictive power for various measures of one-year-ahead performance...that is incremental to their current-period counterparts.” – page 4*

### **Exploit market inefficiencies:**

*“These results ... suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures.” – page 26*

### **Fulfill fiduciary duties:**

*“An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A.” – page 33-34*



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