July 2024 Update with Featured Stock From our Dividend Growth Model Portfolio

I'm back again to give you another free stock pick. Last week, we shared a free featured stock from our Safest Dividend Yields Model Portfolio. Today, we're sharing one from our Dividend Growth Model Portfolio.

The featured stock is not only in the Dividend Growth Stocks Model Portfolio, but it is also in the Most Attractive Stocks and Exec Comp Aligned with ROIC Model Portfolios. In other words, this stock checks a lot of boxes: quality risk/reward, excellent corporate governance and strong dividend growth. It is an extremely valuable pick. So much so, that I almost asked the team to go back and choose a stock that wasn't in so many of our Model Portfolios.

Usually, when people give away things for free, it's because it's worthless to them. That's not the case here. Only Pro and Institutional members get access to all the Model Portfolios listed above, and those memberships start at $999/month.

So, why would we give away something so valuable? The answers:

1. We genuinely believe in improving the integrity of the stock market.
2. We hope to get your business one day.
3. We want to earn your trust and show you the extreme value we deliver.

Out of the 29 stocks in the latest Model Portfolio, we're featuring PACCAR Inc. (PCAR).
Our write-up is below. It is much shorter than a full Long Idea report but provides insights into the kind of analysis we do and helps you set the bar for the value you deserve and should expect from any research firm.

We hope you enjoy it. We hope you find value. Please share with family and friends if you think it would be of interest.

As David shared in a recent training, dividends provide a safe haven in a volatile market, and the stocks in this Model Portfolio have some of the safest dividends in the market.

We update this Model Portfolio monthly and July's Dividend Growth Stocks Model Portfolio was updated and published for clients on July 30, 2024.

Recap from June's Picks

On a price return basis, our Dividend growth Model Portfolio (+8.8%) outperformed the S&P 500 (-0.4%) by 9.2% from June 27, 2024 through July 26, 2024. On a total return basis, the Model Portfolio (+9.0%) outperformed the S&P 500 (-0.4%) by 9.4% over the same time. The best performing stock was up 28%. Overall, 27 out of the 30 Dividend Growth Stocks outperformed their benchmark (S&P 500) from June 27, 2024 through July 26, 2024.

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 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 favor long-term capital appreciation over current income, but still appreciate the power of growing dividends.

Featured Stock for July: PACCAR Inc. (PCAR: $93/share)

PACCAR Inc. (PCAR) is the featured stock in July's Dividend Growth Model Portfolio.

PACCAR has grown revenue and Core Earnings by 7% and 14% compounded annually, respectively, over the past decade. The company's NOPAT margin increased from 7% in 2013 to 13% in the TTM, while invested

[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.

capital turns rose from 2.3 to 2.7 over the same time. Rising NOPAT margins and invested capital turns drive return on invested capital (ROIC) from 16% in 2013 to 36% in the TTM.

Figure 1: PACCAR's Revenue & NOPAT Since 2013

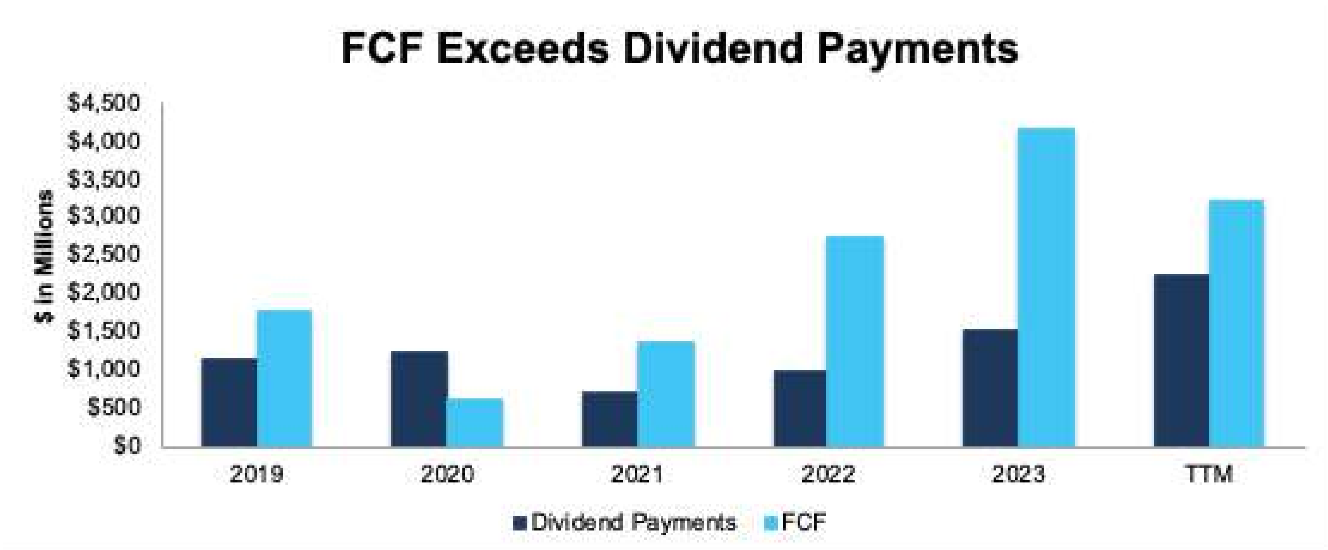
Sources: New Constructs, LLC and company filings

Free Cash Flow Supports Regular Dividend Payments

PACCAR has increased its regular, quarterly dividend from $0.21/share in 3Q19 to $0.30/share in 3Q24 and routinely pays a larger, "year-end-extra", dividend. The quarterly dividend, when annualized, equals $1.20/share and provides a 1.3% dividend yield. Should the company continue paying the year-end-extra dividend, the yield could be much higher.

More importantly, PACCAR's cumulative free cash flow (FCF) easily exceeds its dividend payments. From 2019 through 2Q24, PACCAR generated $10.4 billion (24% of current enterprise value) in FCF while paying $7.6 billion in dividends. See Figure 2.

Figure 2: PACCAR's FCF vs. Dividends Since 2019



Sources: New Constructs, LLC and company filings

Companies with FCF well above dividend payments provide higher-quality dividend growth opportunities. On the other hand, dividends that exceed FCF cannot be trusted to grow or even be maintained.

PCAR Is Undervalued

At its current price of $93/share, PACCAR has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects PACCAR's NOPAT to permanently fall 20% from current levels. This expectation seems overly pessimistic given that PACCAR has grown NOPAT by 17% and 14% over the past five and ten years, respectively.

Even if PACCAR's NOPAT margin falls to 9.3% (equal to 5-year average and below TTM margin of 13.1%) and revenue grows just 6% (compared to 7% compounded annually over the last decade) compounded annually for the next decade, the stock would be worth $130/share today – a 40% upside. See the math behind this reverse DCF scenario. In this scenario, PACCAR's NOPAT would grow just 2% compounded annually through 2033.

Add in PACCAR's 1.3% (or higher) dividend yield and a 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

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

Income Statement: we made over $900 million in adjustments with a net effect of removing over $100 million in non-operating expenses. Clients can see all adjustments made to PACCAR's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made over $9 billion in adjustments to calculate invested capital with a net decrease of over $7 billion. The most notable adjustment was for excess cash. See all adjustments made to PACCAR's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made nearly $7 billion in adjustments, with a net effect of decreasing shareholder value by over $6 billion. Apart from excess cash, the most notable adjustment to shareholder value was for overfunded pensions. See all adjustments to PACCAR's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

This article was originally published on August 9, 2024.

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

Questions on this report or others? Join our online community and connect with us directly.

It's Official: We Deliver 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. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

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

Ernst & Young 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 Harvard Business School. 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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