DSR PREMIUM NEWSLETTER

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This is your site and your exclusive newsletter. Please, feel free to share any ideas, opinions, comments, or suggestions with us via email at dividendustries@gmail.com.

JULY 26th, 2023

Dear DSR member,

It is with great pleasure that we present our weekly premium newsletter which is an important component of your subscription to Dividend Stocks Rock.

You may benefit from viewing our video explaining the differences between the Buy List, our ratings, and our portfolio models. You can retrieve this information in the Videos section of the website.

Referral

Feel free to share our ideas with your friends or associates who may benefit from this information. We would personally consider any referrals you make on our behalf to be the ultimate compliment for our efforts.

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IS STOCK VALUATION A NECESSITY IN YOUR INVESTING PROCESS?

I'll get straight to the point: I don't believe you must include valuation calculations in your investment process. However, this doesn't mean stock valuation is completely useless. In fact, from time to time, this part of your investment process will clearly help you isolate hidden gems and profit from your research.

Stock valuation is closer to fortune telling than science.

Here's my point about stock valuation:

- There are several stock valuation methods that will bring you to various results.
- Each method will require you to make a set of assumptions (cash flow, dividend, earnings growth, etc.).
- Each assumption will include your best guess.
- Each guess will lead to a different result.
- Depending on how you feel, you may find a bargain where I might find you greatly overpaid for a stock.

Here are two examples taken from Refinitiv' analysts' target price database (from of August 17, 2021).

Alimentation Couche-Tard (ATD.TO) price as of August 17, 2021: $51.75

- ✓ Lowest 12-month target price: $45.00 (-12.55%)
- ✓ Highest 12-month target price: $65.00 (+26.31%)
- ✓ Mean (15 analysts): $55.00 (+6.88%)

Apple (AAPL) price as of August 17, 2021: $150.52

- ✓ Lowest 12-month target price: $132 (-12.65%)
- ✓ Highest 12-month target price: $190.00 (+25.73%)
- ✓ Mean (40 analysts): $165.87 (+9.76%)

Both companies show a potential range between -12.5% and +26% with a "consensus" of +7% for ATD and +10% for Apple. Should you buy either stock? Strangely enough, when you look at the "best analysts" (those who are usually right about their price targets), two of the top analysts see ATD at $62 or $47 and AAPL at $190 or $149. Analysts included most Canadian Banks (for ATD) and major investment firms such as Credit Suisse, HSBC, Raymond James, and Argus.

Fast forward to August 17th, 2022, Alimentation Couche-Tard trades at $60.11 (+16%) and Apple trades at $173.56 (+15). Pessimistic analysts in both cases were dead wrong and both investments beat their respective index by a wide margin. In fact, holding ATD and AAPL over the past twelve months was a blessing. So, were they greatly undervalued last year?

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My conclusion after looking at what high-level professionals think of both companies: ***I'm totally confused about how much both stocks will be worth in another 12 months!***

**For this example, I've picked two companies I like and that I have in my portfolio. Similar results are a pure coincidence.*

***For curious readers, the most optimistic price target for Alimentation Couche-Tard and Apple are now $124.55 and $275 as of June 27th, 2024. The most pessimistic analysts see them at $63.53 and $164, respectively. ***

Can you make sense of those analysts' projections?

The thing I dislike the most about stock valuation is that it tends to create doubts in the investor's mind.

What if I pay too much for this company?

Maybe I should wait and buy when the price goes down.

The price went up another 10%, so am I missing a great opportunity?

You get the picture. For this reason, I'll never trigger a buy or sell based solely on stock valuation, and it doesn't mean that I don't look at the price I pay. It is still worth a shot to look at various valuation methodologies to get a better idea of what price you are really paying when you buy shares. This newsletter is about to clear-up the noise created by valuation gurus.

USING DSR TOOLS TO DO IT LIKE A PRO

Making investment decisions based purely on valuation will prevent you from buying amazing stocks while keeping your money on the sidelines for no good reason. However, if you use stock valuation tools to identify where you will get the best return, then you are on the right track. At DSR, we use four different tools to help you identify hidden gems. You can also use DSR valuation tools to raise red flags on companies who are surfing too much on hype and could crash once the bright lights shine on them.

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Dividend Discount Model

I will bet you didn't see this one coming! More seriously, the dividend discount model is provided for all the stock analysis we perform at DSR (on around 400 companies). You can find a detailed explanation of how to read the DDM in the stock card analysis video. The explanation starts at around the 9:40 minute mark.

The Dividend Discount Model (DDM) is a key valuation technique for dividend growth stocks. The most straightforward form of it is called the Gordon Growth Model. This model is used to determine the intrinsic value of a stock based on a future series of dividends that grow at a constant rate. In other words, the model will give you the value to pay today for a stock that will pay and hopefully grow its dividends in the future. Therefore:

- ✓ The DDM will work well with stable companies with a relatively high yield (above 3%).
- ✓ The DDM will NOT work well with low yield, high growth companies (such as Apple).
- ✓ The DDM is extremely sensitive to the dividend growth rate and discount rate. A 1% change could make the difference between an overvalued stock and the bargain of the year.

The number you obtain from the DDM calculation is just the value of future dividends. If you expect some capital growth (as you should), it will not be included in your results. Therefore, I like to use the DDM approach to compare two or more companies operating in the same sector. This strategy is quite helpful to find the "best" dividend grower among companies that look very similar in all other respects. We detailed those valuation steps in the "How to compare two stocks" DSR fundamental newsletter.

We used to provide the upside or downside potential (e.g., DDM value vs current stock price) in our stock screener. We decided to take it off because it was not providing members with a clear assessment. For example, all low yield, high growth potential companies such as Alimentation Couche-Tard, TFI International, Richelieu Hardware, Microsoft, Apple, Visa etc. used to show an important downside potential. Since the DDM only gives value to the dividend, you can't expect a company with a 0.75% yield to show a great "dividend value". However, those companies are usually the ones that will perform the best when you consider total return.

If you wish to go further and learn everything you must about the DDM and how to determine each number used in the calculation, you can read the Dividend Toolkit, also in the DSR fundamental section.

Refinitiv Value Score

Since 2021, we also display a valuation metric from Refinitiv StarMine. If you want to get straight to the point and don't wish to calculate every number, you can rely on this powerful tool. Refinitiv StarMine is a quantitative analytic tool gathering and weighting several metrics together.

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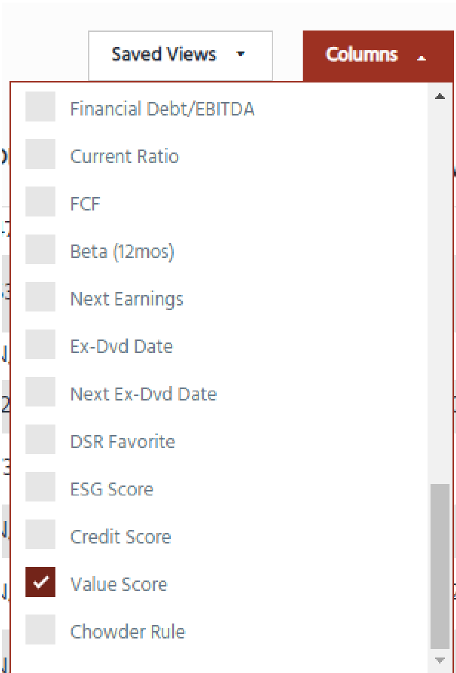

The Refinitiv Value Score will use a combination of 6 valuation metrics:

- EV/Sales
- EV/EBITDA
- P/E
- Price/Cash Flow
- Price/Book
- Dividend Yield

It will then combine them and compare it to other companies on the stock market to give a score between 1 and 100. The current regional 1-100 percentile rank of the security is the overall Relative Value Model. Higher scores indicate stocks with the best value when considering all Relative Value model components that are relevant for the stock.

You can find the Value Score in the stock screener. Then again, **I would never filter by Value Score** to find my next purchase. Why? Because a very high score is likely to lead you towards a company whose stock price has recently fallen, but the financial metrics (out of context) could look good.

The best example I could think of was BlackBerry (previously known as Research in Motion). In 2012, the company was in complete freefall (its famous BlackBerry device was losing market share to Apple's iPhone every second), but financial metrics were stellar. Therefore, all the metrics listed above (except dividend yield) were among the best on the market.

Here's what it looked like in January 2012 (BlackBerry Vs Apple)

FINANCIAL METRICS	BLACKBERRY (BB.TO)	APPLE (AAPL)
EV/SALES	0.32	2.72
EV/EBITDA	1.47	7.57
P/E	3.53	11.54
PRICE/CASH FLOW	24.95	12.61
PRICE/BOOK	0.725	4.928

If we had the Refinitiv Value Score for 2012, we could have been tempted to add BB.TO to our portfolio. All metrics were better for BlackBerry besides the price to free cash flow (there was the red flag!). A thorough analysis was required before looking at valuation metrics. Without it, you wouldn't understand why BB was "so cheap".

Like the DDM, you can use the Refinitiv Value Score to compare two companies in the same industry, but one must remain careful when using valuation metrics exclusively!

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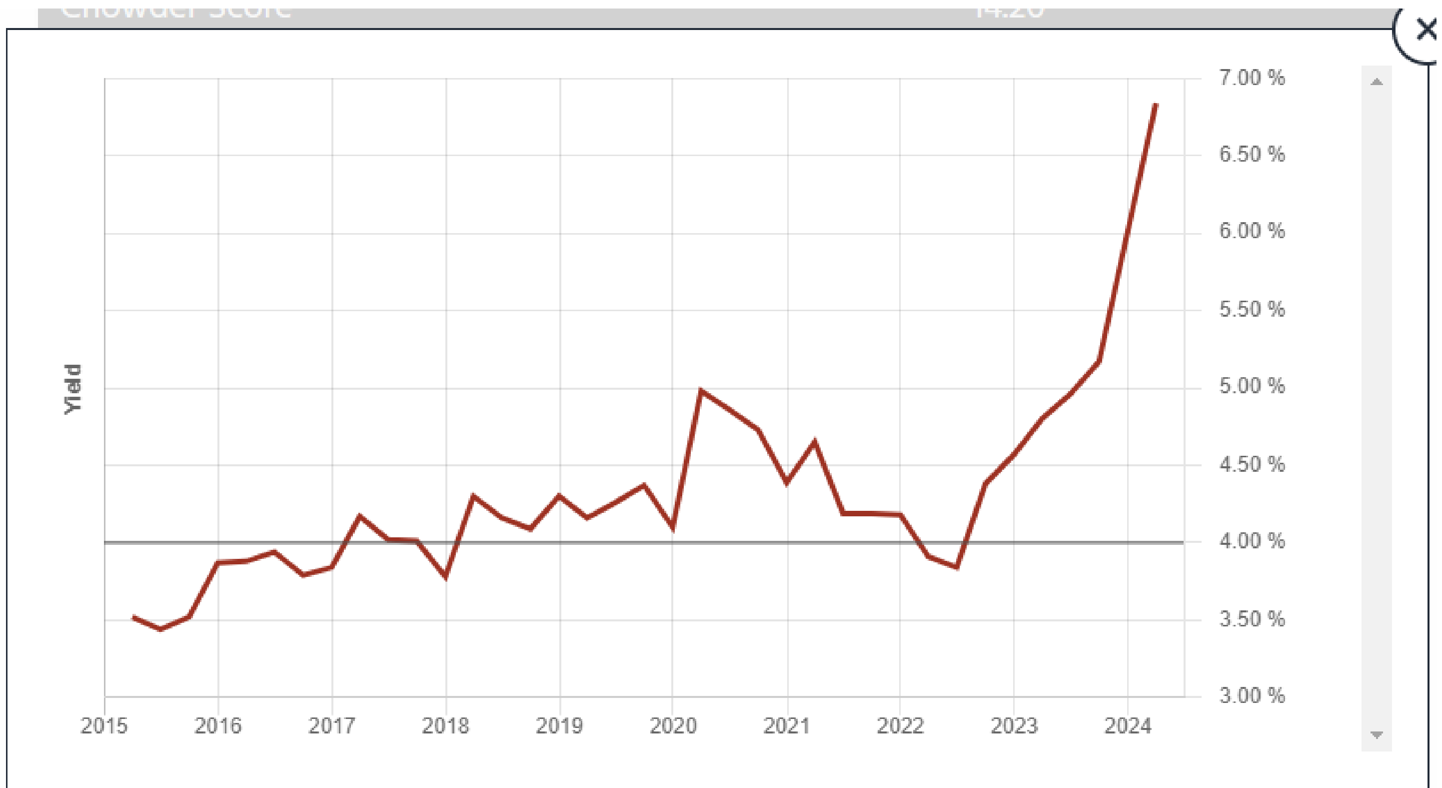
Dividend Yield History

A simple, but effective tool is to look at a company's dividend yield history. You can enlarge any graph on the DSR stock page. For this example, we'll use Telus (T.TO / TU).



The dividend yield may move for two primary reasons:

#1 The dividend increases at a faster pace than the stock price.

#2 The stock price decreases, and the dividend increases or remains intact.

In both cases, you should investigate to know if A) there is a buying opportunity or B) there is a selling opportunity. When you look at the past 5 years of dividend yield history, you can discern what the company's average yield should be. Whenever a company behaves as expected (e.g., continuous growth, stable business model, etc.), the stock price and the dividend are likely to follow a similar trajectory. In other words, the company will offer a similar yield year after year. Whenever the stock is offering you a better yield, there might be a buy opportunity. It's obviously far from being a perfect system but it does give you a hint about when may be the best time to invest in a particular company.

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You can also check the company's 5-year average yield in our stock screener or on the stock page:

Dividend Yield Fwd	7.35 %
Dividend Frequency	Quarterly
Average 5-Yr Yield	5.25 %

When a stock offers a higher yield (forward dividend yield of 7.35%) than its 5yr average (5.25%), it's a good indicator of a possible good deal... or that something may not be right!

Telus saw its yield go up since 2022 stock performance while the dividend continued to increase.

TELUS Corp (T.TO) Price VAL 20.79

36.00
30.00
24.00
20.79
18.00

2020 2021 2022 2023 2024

TELUS Corp (T.TO) Dividend VAL 0.389

0.40
0.389
0.36
0.32
0.28

2020 2021 2022 2023 2024

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Jun 27, 2024, 4:39 PM EDT Powered by YCHARTS

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You can examine the dividend growth rate for 1 year, 3 years and 5 years from the stock screener or on the stock page in the "Dividend Growth Perspective" section:

DGR 1-Yr	7.10
DGR 3-Yr	7.05
DGR 5-Yr	6.75

As you can see, Telus increases its dividend each year at a similar rate.

Keep in mind this methodology is far from perfect. There are many factors for a company to offer a higher yield and it's not always because "the market didn't get it". If a company is having a hard time finding growth vectors or if its dividend growth policy slows down due to weaker cash flow generation, you are not getting any deals here. More context must be added around any dividend yield increase or decrease.

In Telus' case, it's obvious the market is concerned about its raising debt considering higher interest rates. We will see in the cash flow analysis later in this newsletter that Telus is generating enough cash flow to cover its dividend, but the situation is far from being ideal.

PE Ratio History & Forward PE

Like the dividend yield history, looking at a company's price-earnings ratio history will often you understand the story about the company's valuation. As we saw with the Refinitiv Value Score example, a decreasing PE ratio is not always good news.

You can see Telus' PE ratio graph on the stock card showing the past 10 years vs. its average (the gray line).

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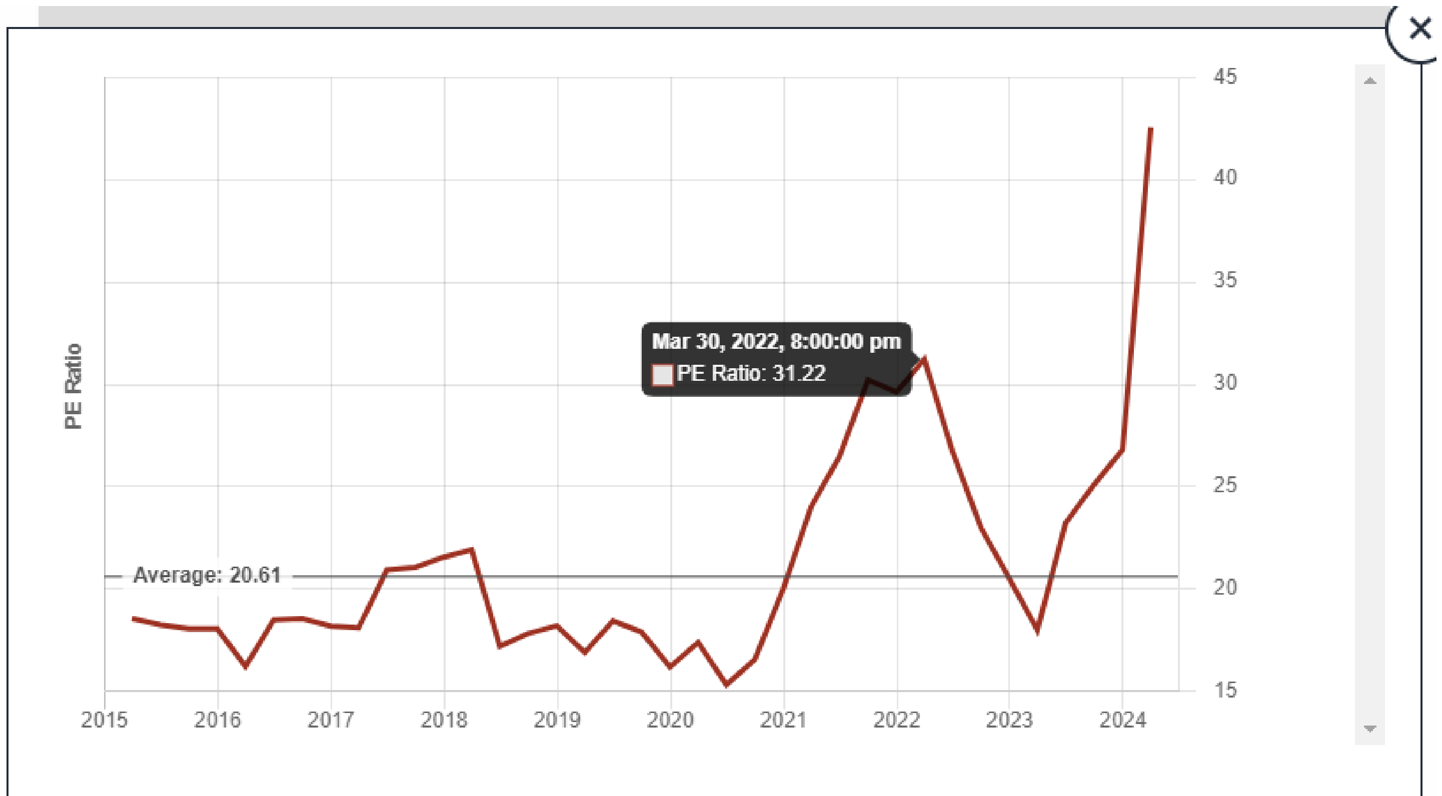

As you will note, the Telus PE ratio is quite hectic and it doesn't tell us much information. However, we can see that the forward P/E is in line with the average of the past 5 years:

PE Ratio	41.40
Fwd PE	19.35
Price to Book Ratio	1.95
DDM Valuation	32.68
Average 5-Yr PE	25.66

For both the dividend yield and the PE history, a strong valuation does not equal a buy or a sell opportunity. It equals an invitation for further investigation.

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OTHER VALUATION METHODOLOGIES

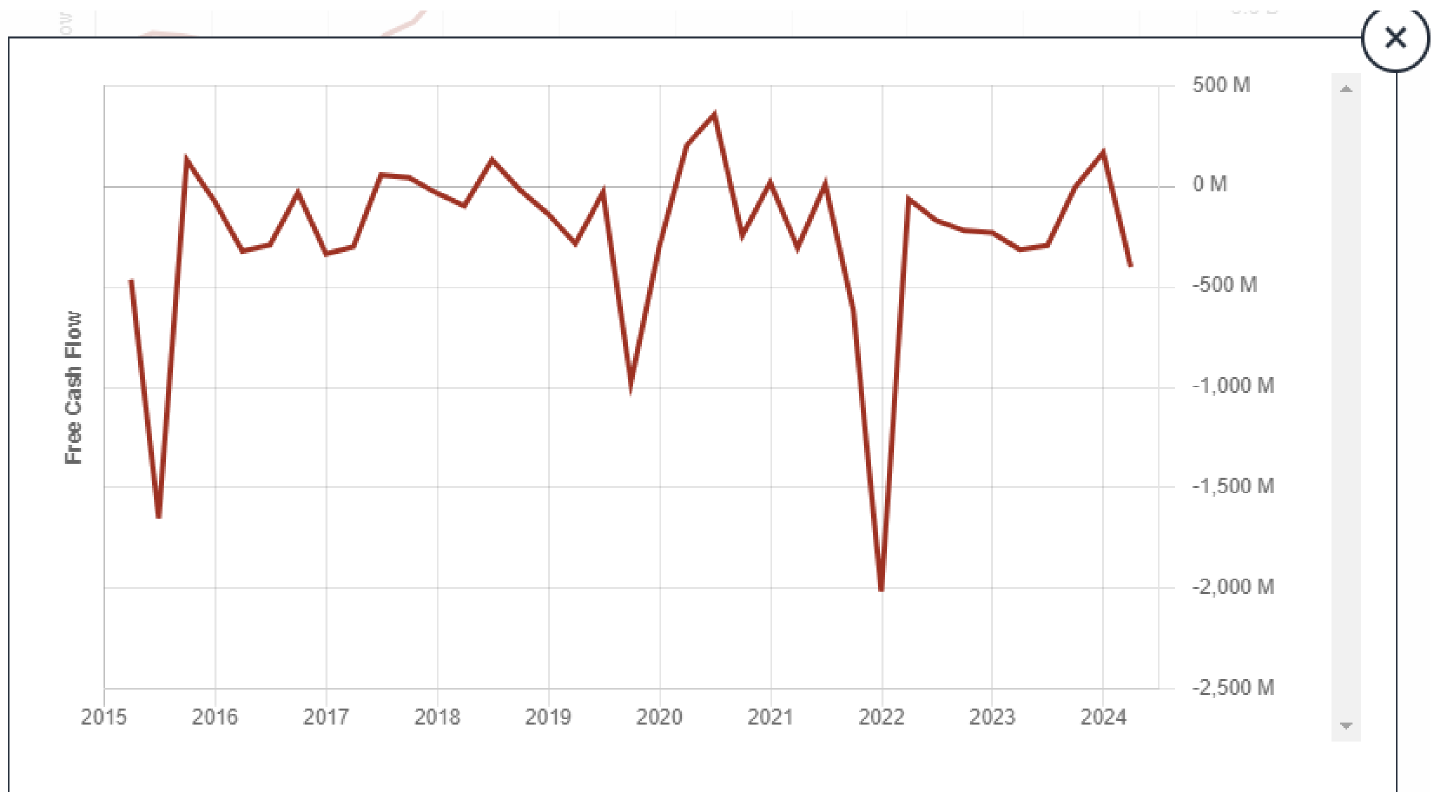
There are many ways to assess a company's value. At DSR, we prefer to keep it simple. We take a quick look at both the dividend and the PE history to see if there are any significant variations that might suggest a buying opportunity. Then we compare the DDM and the Refinitiv Value Score with other companies in the same sector to find the stock trading at the best value. We will always give more weight to the dividend triangle and our investment thesis than the result of our valuation investigation.

For those who want to dig deeper into other forms of stock valuation methods, I've highlighted a few more here.

Discounted Cash Flow Analysis

The Discounted Cash Flow analysis works exactly like the DDM. In short, the premise of discounted cash flow analysis is that a company is equal to the sum value of all future cash flows, but all those future cash flows must be translated into their value today, and this translation uses the process of discounting.

When discounting the value of future cash flows seems like a solid way to calculate the value of a company, determining what future cash flow will be is quite an adventure!



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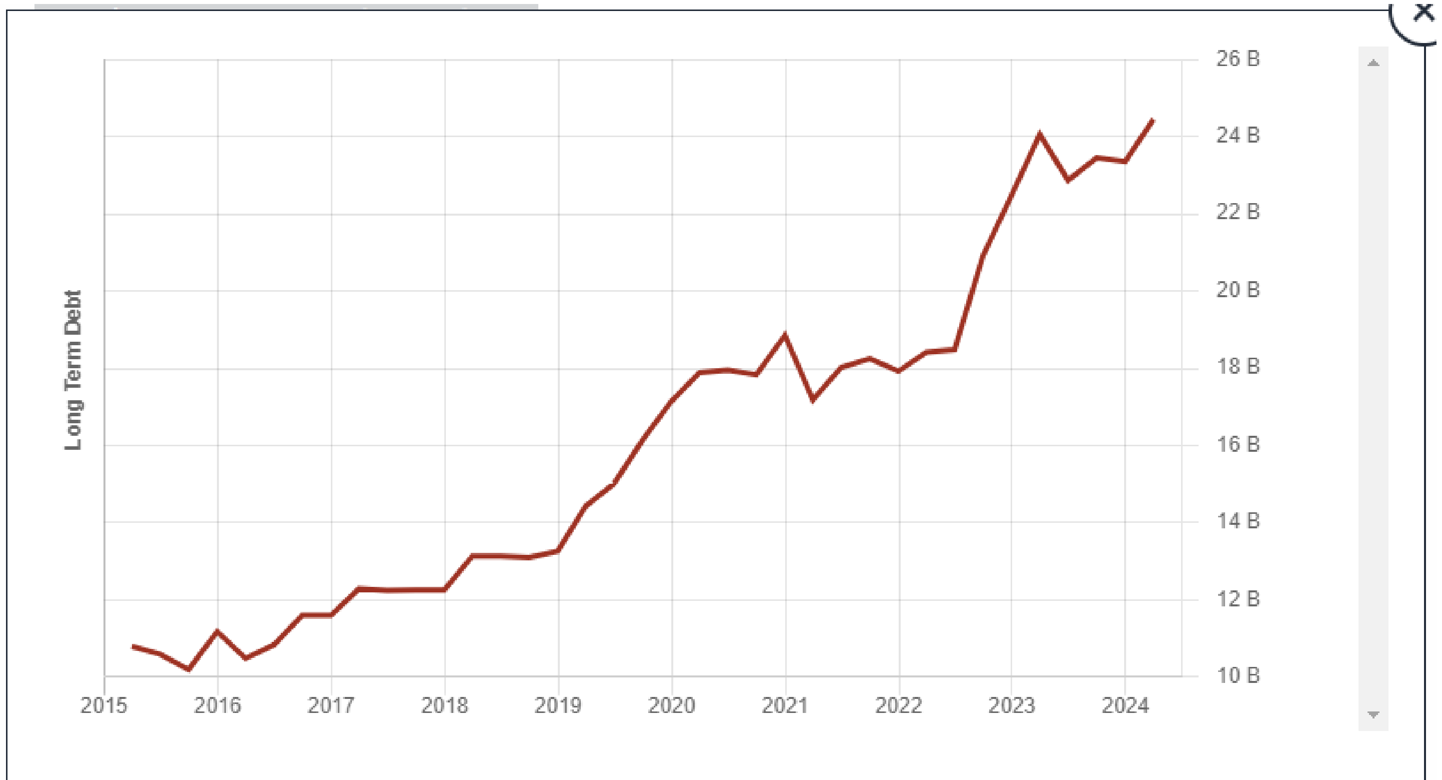
As you can see, even for a capital-intensive company like Telus (e.g., it must spend a lot a of money in developing 5G technology and its global wireless infrastructure), the free cash flow metrics are not the best way to analyze it as it is often in negative territory (e.g., Telus needs more money to invest in its projects than it generates from its current operation). In other words, Telus is very likely to increase its debt levels.



Therefore, determining this number and its future growth trajectory with precision is almost impossible. You might as well close your eyes and throw a dart!

Conclusion: what's the verdict on Telus' valuation?

If we look at all the financial metrics, Telus looks like a great deal right now. However, it is also a reflection of how the market sees risks around their business (notably this huge pile of debt at higher interest rates). In other words, there is a very good reason why Telus looks cheap, it's because the market is not convinced Telus can get back on track and generate more growth.

For the rest of 2024 and for 2025, the key point is to keep monitoring Telus' cash flow metrics. For the first half of the year, the company generated enough cash flow to pay and increase its dividend payout. We'll see in the next quarter if it can keep improving their cash flow metrics. At this point, it's impossible to determine if Telus is trading at a bargain or at a valuation of a struggling company that will go nowhere in 5 years.

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Price to Book, Price to Sales and Price to Cash Flow

On top of the price to earnings (PE) ratio that is commonly used, you can also look at various ratios to compare the stock price to the company's book value, its sales, or its cash flow. I wanted to complete the newsletter with these three calculations to cover all angles, but I don't use them at all. The Price to sales ratio could be used if you want to compare younger companies that are growing quickly, but don't show much profit. This is usually not where you will find dividend growers though! Definitions and calculations are provided by Ycharts.

Price to book value is a financial ratio used to compare a company's book value to its current market price. Book value is an accounting term denoting the portion of the company held by the shareholders at accounting value (not market value). In other words, book value is the company's total tangible assets less its total liabilities.

The ratio has two calculation methods. In the first way, the company's market capitalization is divided by the company's total book value from its balance sheets. The second way, using per-share values, is to divide the company's current share price by the book value per share. In general, a low price to book value indicates that a stock is undervalued and thus possibly more desirable.

In theory, if you purchased stock with a price to book value less than 1 and the company immediately went bankrupt, you would gain money on your investment. This may not be true since there are times when liquidation value, or the price at which a company's assets can be sold, is less than the book value of those assets.

Formula

Price to Book Value = Share Price / Book Value Per Share

Price to Sales Ratio

The price to sales ratio (PS ratio) is calculated by dividing stock price by the revenue per share. It is most useful for comparing companies within a sector or industry because "normal" values for this ratio vary from industry to industry. In general, low price to sales ratios are more appealing because they suggest that a company may be undervalued.

Here is an example illustrating why PS ratios should not be compared across industries: On June 21, 2010, Starbucks had a PS ratio of 1.12 while Yahoo! had a PS ratio of 2.56. In other words, Yahoo! shareholders were paying $2.56 for $1 of sales while Starbucks shareholders were only paying $1.12 for $1 of sales. However, at that same moment, the two companies' price to earnings ratios were virtually identical (Starbucks: 28.09 and Yahoo!: 27.78). Hence, shareholders were paying nearly the same amount for $1.00 in earnings. The PS ratios, though, are less comparable since Yahoo!'s profit margins are much higher than that of Starbucks.

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Formula

PS Ratio = Price / Revenue Per Share

Price to Cash Flow

Price per share divided by cash flow per share. The price to cash flow ratio answers the question, "How much are investors paying for each dollar of cash flow?" A price to cash flow of eight means that the stock price is eight times higher than the stock's free cash flow per share.

A higher ratio means the stock is potentially overvaluing each dollar of free cash. All things being equal, a lower ratio is better.

Formula

Price to Cash Flow = Share Price / Cash Flow per Share

WHAT REALLY WORKS

Investors cannot entirely ignore valuation as an important metric when they want to put their money to work. However, it doesn't mean they should let valuation control their investment decisions. I prefer to use stock valuation methods to add more context to my analysis. The highlighted methods in this newsletter will help me by taking two specific actions:

#1 Knowing where to look and what to look for during my analysis.

Looking at the PE ratio and dividend yield history will tell me a lot about how the market is viewing the company over the past 5 or 10 years. I will use those graphs to guide my investigation. Thanks to those metrics, I'll know in which year to look to identify signs of growth or deceleration. Combining both a historical graph with the dividend triangle will probably explain why a company saw its stock price move on a continuous rise or decline.

A company showing a strong dividend triangle is likely to see some PE expansion. Investors will be willing to pay a higher multiple of profits for a company they believe will continue to grow at a fast pace. For example, the Apple (AAPL) PE ratio doubled over the past 10 years (from 14 to 28). The 2012 version of Apple was one that rode each iPhone launch as their only way to generate growth. The 2022 version of Apple shows a complete ecosystem of integrated products and services with multiple growth avenues. Both companies were great, but expected growth now is greater. Hence, you pay a higher price.

A drop in PE could be led by concerns for slow growth in sales and/or earnings. You can combine both analyses using the graphs in each stock card.

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#2 Compare companies in the same sector.

If I hesitate between a few great companies operating in the same sub-sector, looking at their dividend discount model result and the Refinitiv Value Score will help me identify where I can get the best bang for my buck. Using the DDM, I can compare companies that show a similar dividend growth rate in a similar situation. Therefore, I can use the same discount rate and identify which company offers me the best value for the future dividends received.

To add more layers to your analysis, you can compare Refinitiv Value Scores. After all, the aggregation of multiple valuation metrics is a powerful way to identify undervalued securities within seconds.

A word of caution:

Always keep in mind that the metrics could tell you a different story if you put them in context. Sometimes, low valuation metrics may be indicative of a poorly managed company. **Never forget that the market anticipates future results while financial metrics tells you what happened in the past.** The market is not always correct, yet looking in the rear-view mirror will not tell you what's coming.

The PE ratio and dividend yield history will tell you more about the past and will tell you what the market expects for the future. The DCF and DDM models will only be as good as your assumptions. A change of 1% could make the difference between a bargain and an overvalued stock. Use your calculator with caution.

I hope you have enjoyed this newsletter and that it has brought into context the reasons why I don't really mind the price I pay when I purchase a stock.

Cheers,

Mike.

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