



## Featured Stock in May's Safest Dividend Yields Model Portfolio

12 new stocks make our [Safest Dividend Yield Model Portfolio](#) this month, which was made available to members on May 22, 2019.

Get the best fundamental research

This Model Portfolio leverages our [Robo-Analyst technology](#)<sup>1</sup>, which scales our forensic accounting expertise ([featured in Barron's](#)) across thousands of stocks.<sup>2</sup>

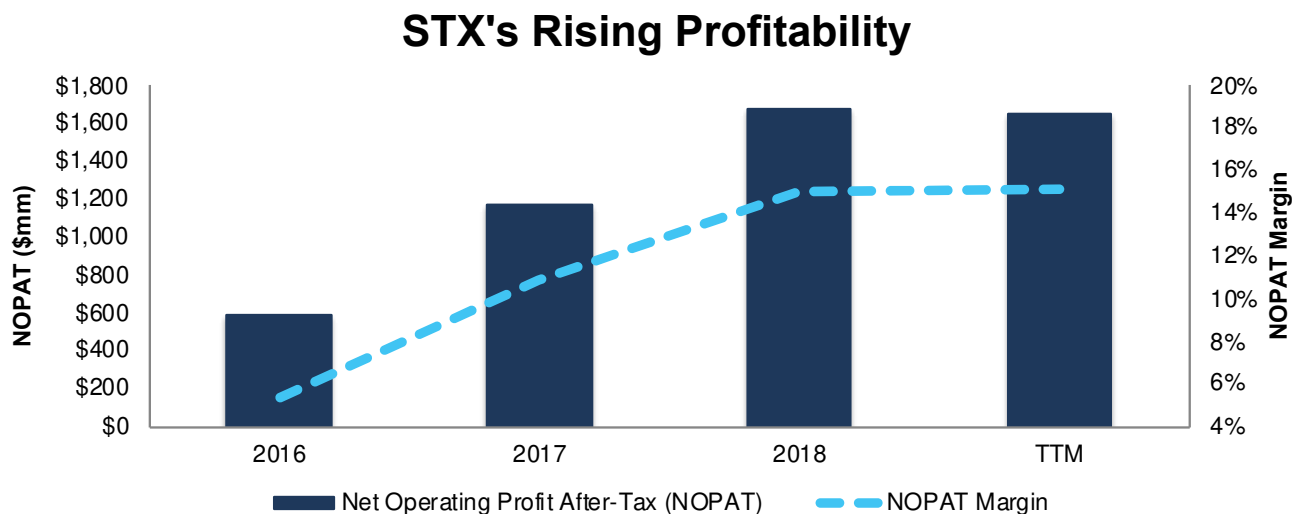
This Model Portfolio only includes stocks that earn an [Attractive or Very Attractive](#) rating, have positive free cash flow and [economic earnings](#), and offer a dividend yield greater than 3%. Companies with strong [free cash flow](#) provide higher quality and safer dividend yields because we know they have the cash to support the dividend. We think this portfolio provides a uniquely well-screened group of stocks that can help clients outperform.

### Featured Stock for May: Seagate Technology (STX: \$43/share)

Seagate Technology (STX) is the featured stock in May's Safest Dividend Yield Model Portfolio.

Since 2016, STX has grown after-tax operating profit ([NOPAT](#)) by an impressive 68% compounded annually. Over the trailing twelve months (TTM), NOPAT has grown 16% year-over-year. NOPAT margin has increased from 5% in 2016 to 15% TTM while return on invested capital ([ROIC](#)) has improved from 8% to a top-quintile 23% over the same time.

Figure 1: STX Profitability Since 2016



Sources: New Constructs, LLC and company filings

### STX's Free Cash Flow Supports Dividend Payments

Over the past five years, STX has increased its annual dividend from \$1.67/share to \$2.52/share, or 11% compounded annually. This dividend payment has been supported by STX's cumulative [free cash flow](#). Despite lower FCF in the TTM period, STX generated cumulative \$6.3 billion (53% of market cap) in FCF since 2014 while paying \$3.2 billion in dividends.

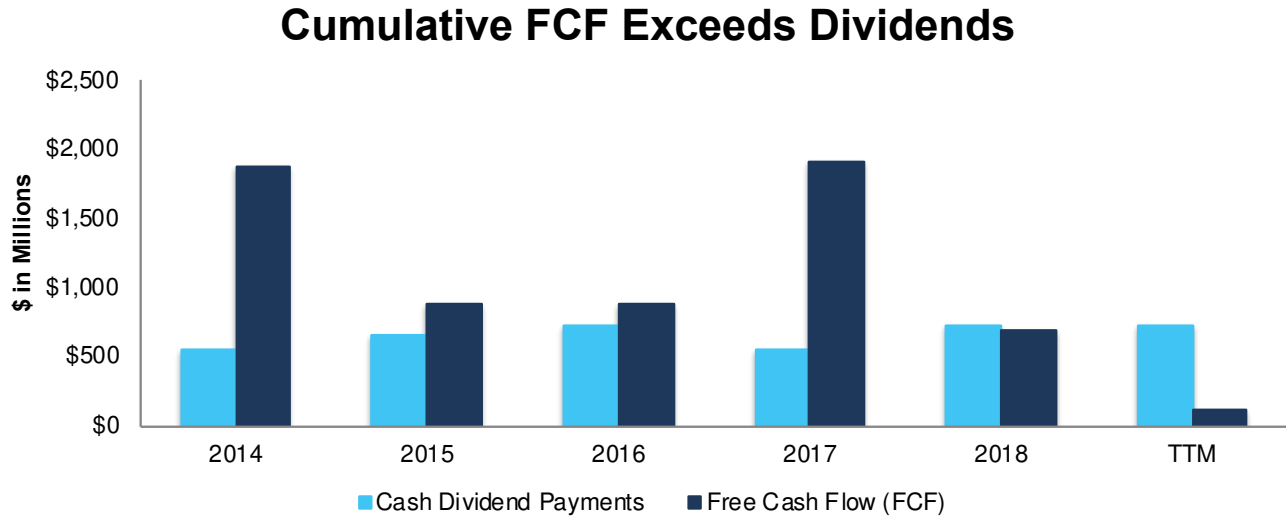
<sup>1</sup> Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).

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



Companies with strong free cash flow provide higher quality dividend yields because we know the firm has the cash to support its dividend. On the flip side, dividends from companies with low or negative free cash flow cannot be trusted as much because the company may not be able to sustain paying dividends.

**Figure 2: STX's FCF vs. Dividends Since 2014**



Sources: New Constructs, LLC and company filings

### STX's Valuation Implies Permanent Profit Decline

At its current price of \$43/share, STX has a price-to-economic book value ([PEBV](#)) ratio of 0.7. This ratio means the market expects STX's NOPAT to permanently decline by 30%. This expectation seems pessimistic given that STX has grown NOPAT by 7% compounded annually since 2003.

If STX can maintain TTM NOPAT margins (15%) and grow NOPAT by just 1% compounded annually for the next decade, the stock is worth \$57/share today – a 33% upside. [See the math behind this dynamic 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](#). Below are specifics on the adjustments we make based on Robo-Analyst findings in Seagate Technology's 2018 10-K:

**Income Statement:** we made \$570 million of adjustments with a net effect of removing \$494 million in [non-operating expense](#) (4% of revenue). See all adjustments made to STX's income statement [here](#).

**Balance Sheet:** we made \$5.5 billion of adjustments to calculate invested capital with a net increase of \$846 million. The most notable adjustment was \$2.6 billion (41% of reported net assets) related to [asset write-downs](#). See all adjustments to STX's balance sheet [here](#).

**Valuation:** we made \$5.5 billion of adjustments with a net effect of decreasing shareholder value by \$3.8 billion. Apart from \$4.6 billion in [total debt](#), which includes \$73 million in [off-balance sheet operating leases](#), the largest adjustment to shareholder value was \$845 million in [excess cash](#). This cash adjustment represents 7% of STX's market value. See all adjustments to STX's valuation [here](#).

*This article originally published on [May 30, 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:***

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.



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