Featured Stock in June's Safest Dividend Yields Model Portfolio

Six new stocks make our Safest Dividend Yields Model Portfolio this month, which was made available to members on June 20, 2019.

Get the best fundamental research

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

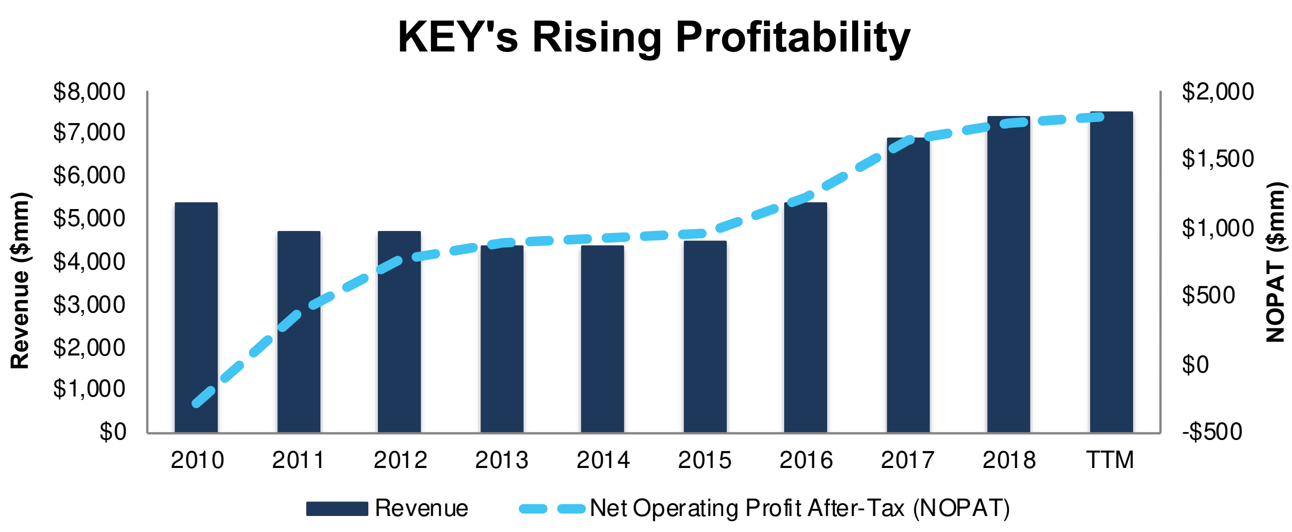
This Model Portfolio only includes stocks that earn an Attractive or Very Attractive rating, have positive free cash flow and economic earnings, and offer a dividend yield greater than 3%. Companies with strong free cash flow provide higher quality and safer dividend yields because we know they have 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 June: KeyCorp (KEY: $17/share)

KeyCorp (KEY), is the featured stock in June's Safest Dividend Yields Model Portfolio.

KEY has grown after-tax operating profit (NOPAT) from -$286 million in 2010 to $1.8 billion over the trailing twelve months (TTM). TTM NOPAT is up 7% over the prior TTM period. NOPAT margin has increased from -5% in 2010 to 24% TTM while return on invested capital (ROIC) has improved from -3% to 10% over the same time.

Figure 1: KEY Profitability Since 2010



Sources: New Constructs, LLC and company filings

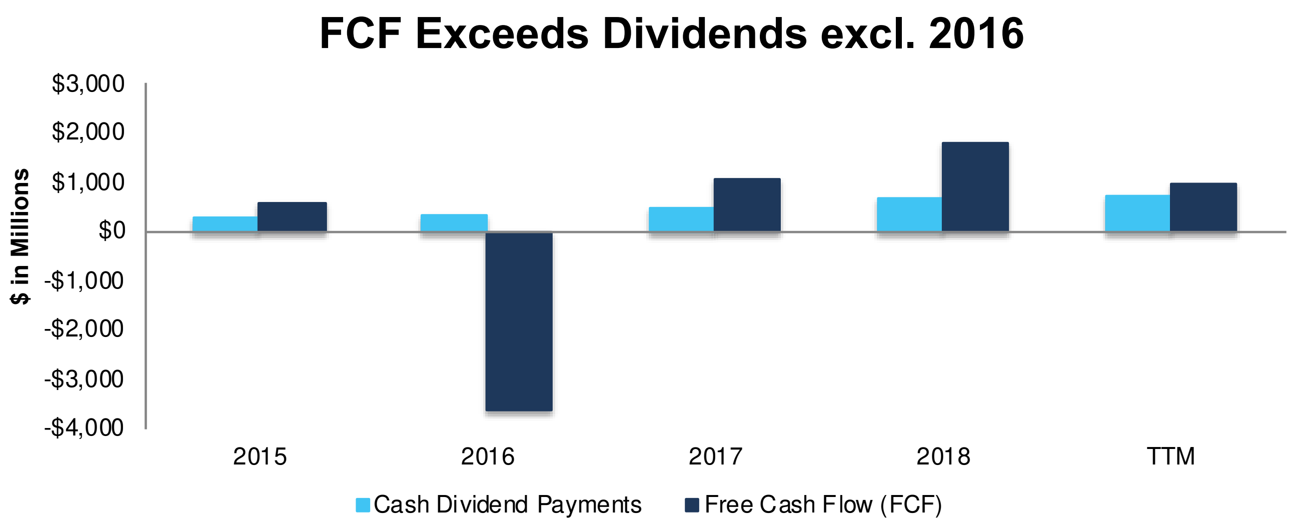
KEY's Free Cash Flow Supports Dividend Payments

Since 2014, KEY has increased its annual dividend from $0.25/share to $0.57/share, or 22% compounded annually. This dividend payment has been supported by KEY's cumulative free cash flow. With the exception of 2016, when KeyCorp acquired First Niagara Bank for $3.9 billion, the company consistently generates the free cash flow necessary to pay its dividend, per Figure 2. In 2017 and 2018 alone, KEY generated $2.8 billion (17% of market cap) in FCF while paying $1.1 billion in dividends.

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

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: KEY's FCF vs. Dividends Since 2014



Sources: New Constructs, LLC and company filings

KEY's Valuation Implies Permanent Profit Decline

At its current price of $17/share, KEY has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects KEY's NOPAT to permanently decline by 20%. This expectation seems pessimistic given that KEY has grown NOPAT by 15% compounded annually over the past five years and 3% compounded annually over the past two decades.

If KEY can maintain TTM NOPAT margins (24%) and grow NOPAT by just 1% compounded annually for the next decade, the stock is worth $22/share today – a 29% 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 KeyCorp's 2018 10-K:

Income Statement: we made $561 million of adjustments with a net effect of removing $31 million in non-operating income (<1% of revenue). See all adjustments made to KEY's income statement here.

Balance Sheet: we made $6.0 billion of adjustments to calculate invested capital with a net increase of $3.2 billion. The most notable adjustment was $1.1 billion (7% of reported net assets) related to asset write-downs. See all adjustments to KEY's balance sheet here.

Valuation: we made $2 billion of adjustments with a net effect of increasing shareholder value by $98 million. The largest adjustment to shareholder value was $1 billion in net assets from discontinued operations. This adjustment represents 6% of KEY's market value. See all adjustments to KEY's valuation here.

This article originally published on June 28, 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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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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