Featured Stock in February's Safest Dividend Yields Model Portfolio

Nine new stocks make our Safest Dividend Yields Model Portfolio this month, which was made available to members on February 20, 2020.

Recap from January's Picks

Our Safest Dividend Yields Model Portfolio underperformed the S&P 500 from January 22, 2020 through February 18, 2020. The Model Portfolio fell 0.1% on a price return basis and rose 0.1% on a total return basis. The S&P 500 rose 1.6% on a price return and total return basis. The best performing large cap stock was up 7%, and the best performing small cap stock was up 11%. Overall, eight out of the 20 Safest Dividend Yield stocks outperformed the S&P 500 & Russell 2000 from January 22, 2020 through February 18, 2020.

Only our research utilizes the superior data and earnings adjustments featured by the HBS & MIT Sloan paper, "Core Earnings: New Data and Evidence." 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.

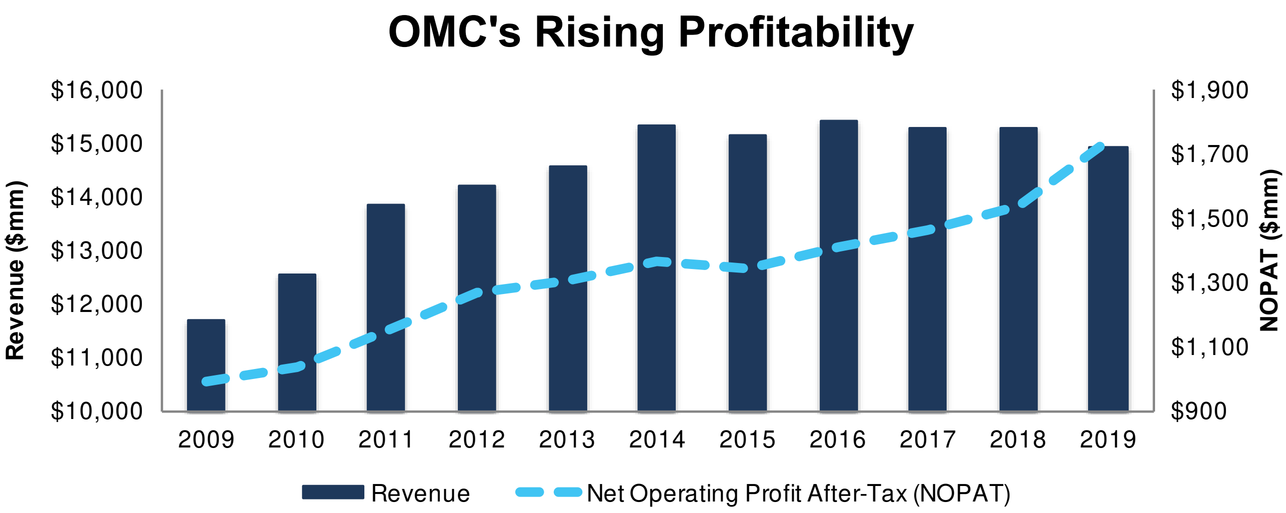
Featured Stock for February: Omnicom Group, Inc. (OMC: $78/share)

Omnicom Group, Inc. (OMC), is the featured stock in February's Safest Dividend Yields Model Portfolio. We made OMC a Long Idea on May 9, 2018 and the stock remains undervalued.

Over the last decade, OMC has grown revenue by 2% compounded annually and after-tax operating profit (NOPAT) by 6% compounded annually. The firm's NOPAT margin increased from 9% in 2015 to 12% in 2019 while return on invested capital (ROIC) improved from 12% to 15% over the same period.

[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 Bloomberg and Capital IQ (SPGI) in a detailed appendix.

Figure 1: OMC's Revenue & NOPAT Since 2009

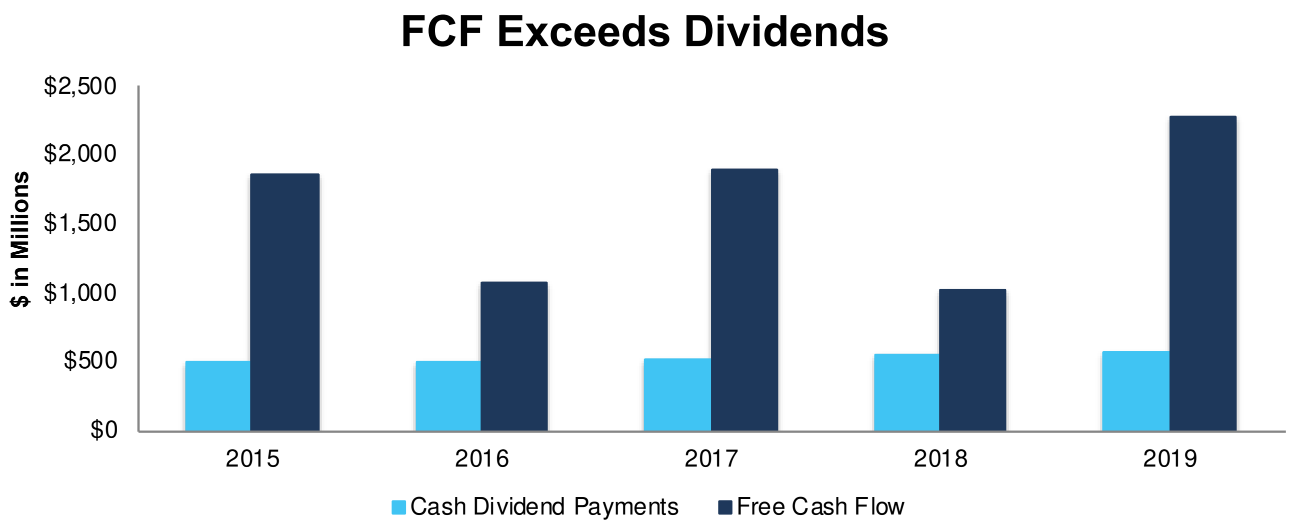


Sources: New Constructs, LLC and company filings

Strong Cash Flow Supports Dividend Payments

Since 2015, OMC has increased its annual dividend from $2.00/share to $2.60/share, or 7% compounded annually. This dividend payment has been supported by OMC's strong free cash flow (FCF). Figure 2 shows the company consistently generates the free cash flow necessary to pay its dividend. OMC has generated $8.1 billion (48% of current market cap) in FCF while paying $2.6 billion in dividends since 2015.

Figure 2: OMC's FCF Vs. Dividends Since 2015



Sources: New Constructs, LLC and company filings

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 other hand, 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.

OMC Remains Undervalued

At its current price of $78/share, OMC has a price-to-economic book value (PEBV) ratio of 0.5. This ratio means the market expects OMC's NOPAT to permanently decline by 50%. This expectation seems overly pessimistic given that OMC has grown NOPAT by 6% compounded annually over the past decade and 7% compounded annually over the past two decades.

OMC's economic book value, or no-growth value, is $160/share – a 105% upside to the current stock price. However, if OMC can maintain TTM margins of 12% and grow NOPAT by just 1% compounded annually for the next decade, the stock is worth $173/share today – a 122% 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 Omnicom Group's 2019 10-K:

Income Statement: we made $835 million of adjustments with a net effect of removing $405 million in non-operating expenses (3% of revenue). See all adjustments made to OMC's income statement here.

Balance Sheet: we made $8.5 billion of adjustments to calculate invested capital with a net increase of $1.3 billion. The most notable adjustment was $1.5 billion (14% of reported net assets) related to operating leases. See all adjustments to OMC's balance sheet here.

Valuation: we made $11.8 billion of adjustments with a net effect of decreasing shareholder value by $4.7 billion. Apart from total debt, which includes the operating leases noted above, one of the most notable adjustments to shareholder value was $727 million in minority interests. This adjustment represents 4% of OMC's market value. See all adjustments to OMC'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.**
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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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